

This electronic thesis or dissertation has been downloaded from the King's Research Portal at <https://kclpure.kcl.ac.uk/portal/>



## Investigating the role of reportable irregularities in South African audit

Maroun, Warren

*Awarding institution:*  
King's College London

The copyright of this thesis rests with the author and no quotation from it or information derived from it may be published without proper acknowledgement.

### END USER LICENCE AGREEMENT



**Unless another licence is stated on the immediately following page** this work is licensed

under a Creative Commons Attribution-NonCommercial-NoDerivatives 4.0 International

licence. <https://creativecommons.org/licenses/by-nc-nd/4.0/>

You are free to copy, distribute and transmit the work

Under the following conditions:

- Attribution: You must attribute the work in the manner specified by the author (but not in any way that suggests that they endorse you or your use of the work).
- Non Commercial: You may not use this work for commercial purposes.
- No Derivative Works - You may not alter, transform, or build upon this work.

Any of these conditions can be waived if you receive permission from the author. Your fair dealings and other rights are in no way affected by the above.

### Take down policy

If you believe that this document breaches copyright please contact [librarypure@kcl.ac.uk](mailto:librarypure@kcl.ac.uk) providing details, and we will remove access to the work immediately and investigate your claim.

This electronic theses or dissertation has been downloaded from the King's Research Portal at <https://kclpure.kcl.ac.uk/portal/>



**Title:** Investigating the role of reportable irregularities in South African audit

**Author:** Warren Maroun

The copyright of this thesis rests with the author and no quotation from it or information derived from it may be published without proper acknowledgement.

#### END USER LICENSE AGREEMENT



This work is licensed under a Creative Commons Attribution-NonCommercial-NoDerivs 3.0 Unported License. <http://creativecommons.org/licenses/by-nc-nd/3.0/>

You are free to:

- Share: to copy, distribute and transmit the work

Under the following conditions:

- Attribution: You must attribute the work in the manner specified by the author (but not in any way that suggests that they endorse you or your use of the work).
- Non Commercial: You may not use this work for commercial purposes.
- No Derivative Works - You may not alter, transform, or build upon this work.

Any of these conditions can be waived if you receive permission from the author. Your fair dealings and other rights are in no way affected by the above.

#### Take down policy

If you believe that this document breaches copyright please contact [librarypure@kcl.ac.uk](mailto:librarypure@kcl.ac.uk) providing details, and we will remove access to the work immediately and investigate your claim.

# **Investigating the role of reportable irregularities in South African audit**

A thesis in fulfilment of the requirement for the degree of:  
Doctor of Philosophy of Kings College London

Warren Maroun  
School of Management  
March 2013

First Supervisor:  
Professor Jill Solomon  
Second Supervisor:  
Mr. Zhiyuan Tan

## CONTENTS

---

Acknowledgements .....	5
Abstract.....	6
I: Lists and schedules.....	7
I: I General abbreviations .....	7
I: II Abbreviated names of legislation.....	8
I: III List of tables.....	9
I: IV List of figures .....	9
1: Introduction .....	10
1.1: Research context .....	10
1.2: Research objectives: Identifying the need for further research .....	12
1.3: Definitions .....	19
1.4: Research scope .....	21
1.4.1: Thesis structure.....	22
1.4.2: Delimitations and assumptions.....	24
2: External audits and whistle-blowing .....	27
2.1: Corporate governance in South Africa, external audit and the RI provisions .....	27
2.1.1: A brief history of South African corporate governance.....	27
2.1.2: Auditing in South Africa .....	30
2.1.3: The reportable irregularity provisions .....	35
2.1.4: Whistle-blowing by external auditors in South Africa .....	37
2.2: An agency theory perspective on audit quality .....	41
2.2.1: Agency theory and the need for external audit .....	41
2.2.2: Audit quality .....	43
2.2.3: External regulation through the lens of agency theory .....	48
2.2.4: A practical perspective on audit quality and external regulation.....	51
2.2.5: An institutional perspective on audit quality .....	55
2.3: Audit quality, external regulation and legitimacy theory .....	56
2.3.1: Legitimacy theory .....	56
2.3.2: An institutional perspective on auditing .....	58
2.3.3: External regulation of the audit profession as a source of legitimacy .....	62
2.3.4: Legitimacy, external regulation and reportable irregularities: A critical perspective .....	71

2.4: The RI provisions: Elements of panopticism? .....	78
2.4.1: Foucauldian power and control .....	80
2.4.2: Power and control in an accounting setting .....	85
2.4.3: Audit as a surveillance mechanism .....	88
2.4.4: Limitations of Foucauldian power and control.....	91
3: Research method and methodology.....	95
3.1: Overview.....	96
3.2: Research design .....	98
3.2.1: Detailed interviews and literature review .....	98
3.2.2: Correspondence analysis .....	102
3.3: Selecting participants .....	107
3.3.1: Population .....	107
3.3.2: Sample selection.....	108
3.3.3: Sample size and access.....	110
3.4: Data collection and analysis .....	111
3.4.1: Detailed interviews .....	111
3.4.2: Correspondence analysis.....	116
3.5: Overview of research quality .....	123
3.6: Summary .....	128
4: Interview findings: Audit quality and s45 of the APA.....	129
4.1: Engagement leader participation.....	130
4.1.1: Requirements of ISQC 1 .....	130
4.1.2: Perceptions of audit experts and informed users.....	131
4.2: Adherence to ethical principles including client acceptance and continuance.....	133
4.2.1: Requirements of ISQC 1 .....	133
4.2.2: Perceptions of audit experts and informed users.....	135
4.3: Human resources, engagement performance and monitoring .....	141
4.3.1: Requirements of ISQC 1 .....	141
4.3.2: Perceptions of experts and users: Execution of engagements .....	143
4.3.3: Perceptions of experts and users: Reporting.....	144
4.4: Summary .....	150
5: Section 45 of the APA and ISQC 1: A correspondence analysis .....	153
5.1: The correspondence plot.....	154
5.2: Discussion.....	156
5.3: Summary .....	160
6: Section 45 of the APA: Perceptions of legitimacy .....	162

6.1: Pragmatic, moral and cognitive legitimacy.....	163
6.1.1: Pragmatic legitimacy: Audit as an example of whistle-blowing .....	163
6.1.2: Whistle-blowing giving rise to moral legitimacy.....	170
6.1.3: On the road to cognitive legitimacy.....	174
6.2: A critical evaluation of the auditor's whistle-blowing duty.....	177
6.2.1: Legitimacy as a by-product of the reportable irregularity provisions.....	178
6.2.2: Symbolic displays to gain legitimacy? .....	183
6.3: Summary .....	192
7: Section 45 of the APA: Notions of disciplinary power .....	194
7.1: Discipline and punish: A case for the RI provisions? .....	195
7.1.1: On principles of enclosure and the efficient body .....	195
7.1.2: On principles of disciplinary power .....	199
7.1.3: An expanded sense of surveillance .....	207
7.2 Disciplinary power as a source of legitimacy .....	210
7.3: A critical perspective on the RI provisions .....	215
7.3.1: Limitations of the RI provisions: Resistance to panopticism .....	216
7.3.2: Foucauldian motifs contributing to ceremonial displays of legitimacy .....	223
7.4: Summary .....	228
8: Conclusion and recommendations .....	231
8.1: Consolidated findings.....	231
8.2: Summary of key contributions .....	241
8.3: Research limitations.....	244
8.4: Closing remarks .....	248
II: Appendices .....	251
Appendix A: Section 45 of the APA.....	251
A1: Definition of a 'reportable irregularity' and related terms .....	251
A2: Duties of the auditor triggered by s45 of the APA .....	254
A3: Duties of the IRBA .....	256
A4: Examples.....	256
A5: Additional considerations .....	259
A6: Example of the first report to the IRBA.....	261
A7: Example of the report issued to the client's management board .....	263
A8: Example of the second report to the IRBA .....	265
Appendix B: Pilot studies .....	267
B1: Pilot of the correspondence analysis.....	267
B2: Appropriateness of the correspondence analysis.....	269

B3: Pilot of the detailed interviews.....	273
B4: Agenda for detailed interviews .....	274
B5: Quality control checklist .....	283
Appendix C: Data manipulation and analysis: Chapter 5.....	286
Appendix D: Ethical clearance confirmation .....	293
Appendix E: Participant consent form .....	295
Appendix F: List of participants .....	297
Appendix G: List of conference proceedings and related publications.....	299
III: Glossary of Terms.....	300
IV: List of References.....	303

## ACKNOWLEDGEMENTS

---

Special thanks must go to:

- Professor Jill Solomon and Mr. Zhiyuan Tan for serving as the first and second supervisor respectively.
- Professor Harvey Wainer for acting as technical consultant for this thesis.
- Lelys Maddock for her editorial services and critique of earlier versions of this report.
- The conference participants and anonymous reviewers who provided invaluable commentary on this thesis and/or research papers based on the thesis (Appendix G).
- The anonymous interviewees for taking the time to share their views on the RI provisions.
- The Skye Foundation and University of the Witwatersrand, for providing partial funding for the research.
- The University of the Witwatersrand and PricewaterhouseCoopers for technical support and making time available to the researcher for carrying out this study.



## ABSTRACT

---

This thesis explores the role of the statutory requirement for South African auditors to report certain irregularities to an independent regulatory body. Detailed interviews with some of the country's leading minds in auditing and corporate governance illustrate how a whistle-blowing duty impacts the functioning of quality control systems. Although the reporting requirement does not result in a paradigm shift in audit practice, it is perceived by some stakeholders as contributing to the scope and relevance of audit reporting. Enacted to enhance corporate transparency, accountability and compliance with laws and regulations, it also becomes an important source of pragmatic, moral and cognitive legitimacy for the audit profession. Motifs of disciplinary power reinforce claims to legitimacy by creating a valid *expectation* of active reporting by auditors in the spirit of promoting effective whistle-blowing. There is, however, no guarantee that every irregularity is reported. The opacity of the audit process allows the practical limitations of the reporting requirement to be decoupled from symbolic displays that reassure stakeholders that external regulation is reforming audit after confidence in its self-regulatory franchise has been eroded by prior scandals. This is not to say that the reportable irregularity provisions are irrelevant. What these findings highlight is that the plurality of external regulation gives rise to varied (and at times conflicting) views on arms-length control of the profession.

In this way, the research adds to the auditing literature by avoiding the mainstream approach of using inferential testing to make an economic case for external regulation. Instead, an interpretive technique highlights the relevance of powerful social and institutional forces shaping regulatory practice. Critical analysis of an example of a recently amended reporting requirement also provides an interesting case study for exploring real-world issues when it comes to the application and effect of external regulation, simultaneously offering evidence in support of the social construction of audit practice, quality control and credibility theorised by leading institutional auditing researchers such as Humphrey and Power. The research is also the first to examine the role of a whistle-blowing duty for South African auditors, despite the statutory requirement dating to the 1950's. This is not only useful for local practitioners and academics seeking better to understand the legal duty: by contributing to the scant body of critical auditing research in an African setting, this research highlights important conceptual issues which are relevant for informing the on-going debate on the role of external regulation in ensuring high quality audit practice, relevant and reliable audit reports and the continued credibility of the attest function.

## I: LISTS AND SCHEDULES

### I: I GENERAL ABBREVIATIONS

Abbreviation	Full Name	Jurisdictions
ACCA	Association of Chartered Certified Accountants	International
AICPA	American Institute of Certified Public Accountants	USA
AIU	Audit Inspection Unit (part of the FRC)	UK
APC	Auditing Practices Committee	South Africa
APB	Auditing Practices Board	UK
The Big Four	Deloitte, Ernst Young, KPMG and PricewaterhouseCoopers	Various
CA	Chartered Accountant	South Africa
CA(SA)	The professional designation : Chartered Accountant (South Africa)	South Africa
CESR	Committee of European Securities Regulators	Europe
CICA	Canadian Institute of Chartered Accountants	Canada
CIMA	Chartered Institute of Management Accountants	International
CPA	Certified public accountant	USA
EU	European Union	Europe
E&Y	Ernst & Young	International
FRC	Financial Reporting Council	UK
FSA	Financial Services Authority	UK
GAAS	Generally Accepted Auditing Standards	Various
IAASB	International Auditing and Assurance Standards Board	International
IASB	International Accounting Standards Board	International
ICAEW	Institute of Chartered Accountants in England and Wales	UK
ICAS	Institute of Chartered Accountants of Scotland	UK
ICSA	Institute of Chartered Secretaries and Administrators	UK
IFAC	International Federation of Accountants	International
IFRS	International Financial Reporting Standards	International
IFRS for SME's	International Financial Reporting Standards for Small and Medium-sized Entities	International
IIRC	International Integrated Reporting Committee	International
IOD	Institute of Directors in Southern Africa	South Africa
IRBA	The Independent Regulatory Board for Auditors	South Africa
IRC	Integrated Reporting Committee of South Africa	South Africa
ISA	International Standards on Auditing	International
ISAE	International Standards on Assurance Engagements	International
ISQC 1	ISQC1: Quality Control for Firms That Perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Services Engagements	International
ISRE	International Standards on Review Engagements	International
ISRS	International Standards on Related Services	International

Abbreviation	Full Name	Jurisdictions
ITT	International Telephone and Telegraph	USA
JSE	Johannesburg Securities Exchange	South Africa
King-I	The King Report on Corporate Governance (1994)	South Africa
King-II	The King Report on Corporate Governance in South Africa (2002)	South Africa
King-III	The King Code of Governance for South Africa (2009) and King Report on Governance for South Africa (2009)	South Africa
MI	Material irregularity	South Africa
OECD	Organisation for Economic Cooperation and Development	International
PAAB	Public Accountants and Auditors Board	South Africa
PCAOB	Public Company Accounting Oversight Board	USA
POB	Public Oversight Board	USA
PwC	PricewaterhouseCoopers (Incorporated)	International
RA	Registered auditor	South Africa
RAA	Registered accountants and auditors	South Africa
RI	Reportable irregularity	South Africa
SAAA	The Southern African Accounting Association	South Africa
SAAPS	South African Auditing Practice Statements	South Africa
SAICA	South African Institute of Chartered Accountants	South Africa
SAS	Statement on Auditing Standard	USA
SEC	Securities Exchange Commission	USA
SOX	The Sarbanes Oxley Act (2002)	International
The Code	The International Federation of Accountants' Code of Professional Conduct	International
USA/US	United States of America/United States	USA

## I: II ABBREVIATED NAMES OF LEGISLATION

Abbreviation	Full Name	Jurisdictions
APA	Auditing Profession Act No. 26 of 2005.	South Africa
Companies Act (1973)	Companies Act No. 61 of 1973.	South Africa
Companies Act (2008)	Companies Act No. 71 of 2008.	South Africa
CA	Chartered Accountants Designation (Private) Act No. 13 of 1927	South Africa
FICA	Financial Intelligence Centre Act No. 38 of 2001	South Africa
MLR	Money Laundering Regulations 2003, No. 3075.	UK
PAAA	Public Accountants' and Auditors' Act No. 80 of 1951	South Africa
PIDA	Public Interest Disclosure Act of 1998	UK
POCA	Prevention of Corrupt Activities Act No. 121 of 1998	South Africa
SOCPA	Serious Organised Crime and Police Act of 2005	UK
SOX	Sarbanes-Oxley Act of 2002, Pub. L. 107-204, 116 Stat. 745	USA
WPA	Whistleblower Protection Act of 1989, Pub. L. 101-12, 103 Stat. 16	USA

## I: III LIST OF TABLES

---

Table 3.1: Correspondence table .....	105
Table 3.2: Axial codes used for data analysis .....	113
Table 3.3: Descriptive statistics for correspondence analysis .....	117
Table 3.4: Labelling of the axes .....	118
Table 3.5: Correspondence table matrix.....	120
Table 3.6: Statistics for row categories in symmetric normalization .....	121
Table 3.7: Statistics column categories in symmetric normalization .....	122
Table 3.8: Validity risk summary and approach to mitigate those risks .....	123
Table 5.1: Row and column labels .....	155
Table 3.1: Correspondence table (reproduced) .....	268
Table B1: Risk matrix .....	283
Table B2: Relying on the comments of experts and informed users .....	285
Table C1: Descriptive statistics for the correspondence analysis .....	287
Table C2: Summary of dimensions and associated explanatory power .....	287
Table C3: Labelling of the axes .....	290
Table C4: Statistics for column categories in symmetric normalisation (reproduced).....	291
Table C5: Statistics for row categories in symmetric normalisation (reproduced) .....	292
Table F1: List of interviewees.....	297
Table G1: List of conference proceedings .....	299

## I: IV LIST OF FIGURES

---

Figure 1.1: Thesis structure.....	23
Figure 3.1: Diagrammatic overview of the content analysis .....	99
Figure 3.2: Diagrammatic overview of research approach.....	127
Figure 5.1: Final correspondence plot .....	154
Figure 8.1: Thesis structure.....	240
Figure B2: Survey responses: Appropriateness of using a correspondence analysis .....	271
Figure C1: Scree plot .....	288
Figure C2: Correspondence plot .....	289

# 1: INTRODUCTION

---

## 1.1: RESEARCH CONTEXT

---

In South Africa, over and above the duty to express an opinion on a client's financial statements, the external auditor is obligated, in terms of s45 of the Auditing Profession Act No. 26 of 2005 (APA), to bring 'reportable irregularities' (RI's) to the attention of an independent regulator: the Independent Regulatory Board for Auditors (IRBA). This additional reporting requirement, which may be regarded loosely as a form of whistle-blowing, has its genesis in the 1950's when the South African Government took the position that auditors owed a duty to society to do more than just provide a generic opinion on financial statements.

Subsequently, the collapse of Apartheid, the country's reintroduction to the global market and persistent socio-economic challenges has served as an impetus for local corporate governance reform (Rossouw et al, 2002; West, 2006; Diamond and Price, 2012). The audit profession has not been insulated from this. The introduction of the King Report on Corporate Governance (King-I) during 1994 provided the country with a governance framework which included a clear focus on the relevance of high quality external audit to serve the information needs of shareholders (Institute of Directors [IOD], 1994). This thinking was confirmed with the release of King Reports in 2002 and 2009 which continued to emphasise the importance of external audit as an instrument of accountability, transparency and sound governance (IOD, 2002; IOD, 2009; PricewaterhouseCoopers [PwC], 2009; Solomon, 2010). Complementing this are revisions to codes of professional conduct, the introduction of additional auditing standards and the alignment of South African audit practice with international trends (PAAA, 1951; IOD, 1994; Nel, 2001; Puttick and van Esch, 2003).

The momentum for change continued into the 2000's. A series of international corporate failures<sup>1</sup>, which directly or indirectly implicated auditors, led to a number of changes in the international audit arena (Unerman and O'Dwyer, 2004; Malsch and Gendron, 2011). The enactment of the Sarbanes Oxley Act (2002) (SOX) and formation of the Public Company

---

<sup>1</sup> For example, 'Enrongate' cost the American investor over \$55 billion. Scandals at Tyco and WorldCom added a further \$6 and \$3.8 billion respectively to the tab. This was followed by a restatement of revenue at Bristol-Myers of some \$2.5 billion.

Accounting and Oversight Board (PCAOB) are the most common examples. A growing concern that capitalistic pressures at work on audit firms had detracted from the quality and reliability of audit reports was resulting in a wide-spread withdrawal of trust from the audit profession, necessitating the use of additional external regulation purportedly to reform the profession and restore confidence in it (Unerman and O'Dwyer, 2004; Canada et al, 2008; Riotto, 2008; Sy and Tinker, 2008; Arping and Sautner, 2012). South Africa was not exempt from this, especially after having to deal with a number of local corporate failures. As a developing economy, and relatively young democratic society, maintaining (at the very least) parity with international corporate governance developments is paramount for securing the legitimacy of its capital markets<sup>2</sup> (West, 2006; Diamond and Price, 2012). As such, a number of statutory amendments were proposed echoing comparable moves in the USA and European Community (Konar et al, 2003). These include: mandatory partner rotation periods (s92 of the Companies Act, 2008); restrictions on the rendering of non-audit services (s44(6) of the APA, 2005; s93(3)a of the Companies Act, 2008); and regulation of audit committees' duties (s94(7) of the Companies Act, 2008). Included in these audit-focused reforms, the APA superseded the Public Accountants and Auditors Act No. 80 of 1951 (PAAA) with an aim to, *inter alia*, entrenching audit's role in serving the public interest (s2 of the APA). As part of this, the whistle-blowing duty enshrined in s20(5) of the PAAA was broadened and firmly entrenched in audit practice under s45 of the APA (Section 2.1).

To date, South Africa remains one of the few jurisdictions where the auditor is faced with a *generic*<sup>3</sup> duty to blow the whistle on certain client transgressions (Nel, 2001; Maroun and Gowar, 2013). This has been justified on the grounds that the standard audit report lacks sufficient depth, it being possible for the auditor to issue a clean report despite the occurrence of 'acts' or 'omissions' which may be contrary to the interests of various stakeholders (Nel, 2001; IRBA, 2006). The European Commission (2010b) International Auditing and Assurance Standards Board (IAASB) (2012) and Solomon (2009) make similar arguments, pointing out that, currently, audit reports ought to provide additional insights into audit findings in the name of enhanced governance. In addition, the statutory reporting duty forms part of the move towards more external regulation of the profession, aimed at reassuring stakeholders that regulators are responding to previous corporate debacles that have left trust in the audit practice shaken (Unerman and O'Dwyer, 2004; Malsch and Gendron, 2011; Tremblay and Gendron, 2011).

---

<sup>2</sup> This aspect of this thesis was discussed in detail at the Critical Perspectives on Accounting Conference (2011) (see Appendix G).

<sup>3</sup> France, Malaysia, the United Kingdom and USA are examples of jurisdictions where auditors may be required to report issues noted during an audit to a third party. These duties are, however, in terms of the relevant auditing standards or apply in only limited circumstances, such as when dealing with money laundering (Schultz et al, 1993; Nel, 2001; Maroun and Gowar, 2013).

Finally, local policy-makers were disappointed by the relatively low number of irregularities being reported under the PAAA and were worried that this signalled a lack of propensity by auditors to discharge their reporting duty, even if this was in the public interest (Nel, 2001; Manuel, 2002; Negash et al, 2003; IRBA, 2012b). These concerns were particularly relevant in a climate of deepening suspicion about the quality of audit reports and role of the attest function in protecting the interests of stakeholders (Unerman and O'Dwyer, 2004; Opperman, 2009). A mandated whistle-blowing duty per the APA - with broader applicability than under the PAAA - backed by sanctions for non-compliance was, therefore, promoted as a means of cultivating a reporting culture that not only adds to the scope of information made available by auditors but fosters improved compliance with laws, regulations and corporate governance standards (Nel, 2001; Opperman, 2009). In turn, the perceived relevance and standing of the audit profession in South Africa would be bolstered (Nel, 2001; Opperman, 2009). The academic literature on whistle-blowing supports this thinking, stressing how blowing the whistle can reduce corporate malfeasance, improve compliance with regulations and enhance a commitment to sound governance (Vinten, 2000; Vinten, 2003; Nam and Lemak, 2007; Hwang et al, 2008; Reckers-Sauciuc and Lowe, 2010; Seifert et al, 2010).

Ultimately, that South Africa has been ranked first globally for the quality of audit and reporting standards (IRBA, 2010b; IRBA, 2012c; King, 2012) and that international trends point to a growing use of arms-length checks and balances to restore users' confidence in the audit process (Malsch and Gendron, 2011) appears to confirm the appropriateness of the country's recent regulatory efforts. In this climate, s45 of the APA has become an accepted feature of South African audit practice. To date, however, there has been little formal research on local auditor regulatory developments and virtually no consideration of the role played by reporting irregularities in South African audit, despite the whistle-blowing duty being in effect for almost seventy years.

## **1.2: RESEARCH OBJECTIVES: IDENTIFYING THE NEED FOR FURTHER RESEARCH**

---

The primary objective of this thesis is to consider the role played by s45 of the APA (the RI provisions) in South African audits. This is done from three angles, inspired by agency theory (Chapter 4; Chapter 5), legitimacy theory (Chapter 6) and Foucauldian theories of power and control (Chapter 7).

In the light of the current debate on regulatory oversight for the audit profession and the scope and quality of audit reports (Committee of European Securities Regulators [CESR], 2007; European Commission, 2010b; Integrated Reporting Committee of South Africa [IRC], 2011; IAASB, 2012), this research explores the perceived impact of a complementary statutory reporting duty on quality control systems (Chapter 4; Chapter 5) and the professional standing of South African audit firms (Chapter 6; Chapter 7). This is not only relevant for practitioners devoting considerable resources to ensuring compliance with laws and regulations and the execution of high quality audit engagements (IAASB, 2009x): the research is also one of the first to explore formally the role of a whistle-blowing duty (Section 2.1.4) in the arms-length audit regulatory environment, rather than simply assuming that the proliferation of external regulation is synonymous with an improvement in audit quality (Vakkur et al, 2010; Defond and Lennox, 2011; Humphrey et al, 2011). As explained by Humphrey et al (2011, p. 444), 'there is still much being missed with respect to what is known and/or not known about audit quality' and the impact of regulatory developments on quality control systems. This is especially true when it comes to the RI provisions, given the absence of direct research on the reporting requirements, despite the whistle-blowing duty originating in the 1950's (Nel, 2001).

To avoid the risk of traditional positivist approaches oversimplifying the relationship between regulatory oversight and quality control systems (Ahrens and Chapman, 2006; Humphrey, 2008), the thesis relies on detailed interviews with leading auditing and corporate governance experts (O'Dwyer et al, 2011). This allows the researcher to understand better how those practitioners interpret and apply regulatory requirements. A detailed account of the RI provisions also indicates the need for more interpretive case studies on the impact of external regulation on audit practice identified by Power (2003), Khalifa et al (2007) and Humphrey et al (2008; 2011).

The resulting normative stance should not be regarded as a threat to validity in a positivist sense. Instead, by relying on a qualitative approach (Chapter 3), the research concentrates on the practicalities of auditing (Power, 2003), asking questions about what might or should be happening in regulatory circles. As explained by Humphrey et al (2011), this style of research is particularly important for shedding light on the little studied interaction between audit regulation, practice and quality (see also O'Dwyer et al, 2011). A critical review of audit regulation is also relevant due to the proliferation of arms-length regulation over the last decade (Maslch and Gendron, 2011). A number of studies have tested the impact of recently enacted regulatory measures, such as the introduction of PCAOB inspections, on quality surrogates usually in experimental settings or using archival data (for example, Carcello et al, 2011; DeFond and Lennox, 2011; Arping and Sautner, 2012). There are,



however, a great number of factors that impact on audit quality and practice which, due to the inherent limitations of quantitative techniques, have been largely overlooked by mainstream audit research (see Power, 2003; Khalifa et al, 2007; Humphrey et al, 2008).

Connected with this is the need to examine the issue of audit regulation and quality in an African context<sup>4</sup> (Power, 2003; Brennan and Solomon, 2008; Humphrey, 2008; Humphrey et al, 2011). Most of the prior auditing research is based in the USA, Europe or Australia (see Francis, 2004; Carcello et al, 2011; Humphrey et al, 2011). Furthermore, there has been almost no interpretive or critical auditing research in South Africa (see Coetsee, 2011; Maroun, 2012a). Studying s45 of the APA is, however, not only relevant for contributing to the scant body of local research on audit quality and practice. With auditors placed firmly in the public spotlight following a series of well-publicised scandals and the on-going financial crisis, South Africa's RI provisions, which were only recently amended (Section 2.1.3), provide a specific and current example of external regulation aimed at, *inter alia*, contributing to the scope and quality of audit reports (Nel, 2001; Manuel, 2002). The whistle-blowing duty (Section 2.1.4) is, therefore, an interesting case study for interpretively examining the practical quality control issues being dealt with by practitioners and the perceptions of informed users of audit reports (see Reiter and Williams, 2002; Harmon, 2006; Davila and Oyon, 2008; Scapens, 2008). It simultaneously adds to the current debate on the sufficiency of traditional audit reporting and underlying quality control systems for ensuring relevant and reliable audit reports (Sikka et al, 2009; European Commission, 2010b; Humphrey et al, 2011; IAASB, 2012).

With the relationship between regulatory activity and the effectiveness of quality control systems at audit firms (and audit quality in general) not yet resolved in the academic literature (Carcello et al, 2011; Humphrey et al, 2011), the first part of this thesis explores the perceived impact of the RI provisions on the quality control systems of South African audit firms. DeAngelo (1981a; 1981b) and Palmrose (1988) define 'audit quality' as the joint probability of detecting and reporting material financial statement errors. 'Audit quality' can, however, be neither quantified nor directly observed (Power, 2003; Boone et al, 2010; Carrington, 2010). As a result, traits pointing to high quality audits are studied (for examples, see Deis (Jr.) and Giroux, 1992; Deis and Giroux, 1996; Frantz, 1999; Fuerman, 2004; Bedard, 2012; Firth et al, 2012; Nagy, 2012; Wines, 2012; Zerni, 2012). For the purpose of this thesis, these 'traits' are those per *ISQC1: Quality Control for Firms That Perform Audits*

---

<sup>4</sup> That South Africa is the continent's largest and best developed economy, and a leader in the area of corporate governance (King, 2012), further justifies the use of a South African-specific focus in this paper.

*and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements* (ISQC 1) (IAASB, 2009x):

- leadership responsibilities for quality within the firm, including adherence to relevant ethical requirements;
- acceptance and continuance of client relationships and specific engagements;
- human resources and engagement performance (including consultation, monitoring and review); and
- monitoring of quality controls within the audit firm.

(van Esch et al, 2004; IAASB, 2009x)

In keeping with an interpretive epistemology, agency theory is applied in Section 2.2 only to set the scene for the introduction of external audit as part of a system of checks and balances to mitigate agency costs (Jensen and Meckling, 1976; Watts and Zimmerman, 1983; Ashbaugh and Warfield, 2003). The section also explains how a conflict between serving the interests of stakeholders and capitalistic incentives detracts from the independence of the audit profession, making a case for more arms-length regulation to ensure high levels of audit quality (Negash et al, 2003; Bazerman and Moore, 2011; Firth et al, 2012). The aim is not to develop an economic case for regulatory developments but to provide a context for interpretively analysing the views of auditing and corporate governance experts on the perceived impact of s45 of the APA on each of the quality control elements outlined by ISQC 1 (Chapter 4; Chapter 5). This ensures that the emphasis is not on remote inferential testing of quality surrogates (as with the majority of positivist studies) but on the views of individuals engaged at the interface between theory and practice<sup>5</sup> (Power, 2003; Humphrey, 2008) and the 'real life day-to-day drivers of audit quality' (Humphrey et al, 2011, p. 450).

Interconnected with the external regulation and its impact on quality control systems is the issue of the credibility of the attest function and its taken-for-granted-status as part of the corporate governance system (Power, 1994; Humphrey et al, 2011). A quantitative finance paradigm, engendering a shareholder-centric view of corporate governance has become prevalent (Brennan and Solomon, 2008) and with it, perspectives on governance bounded by the assumption of rational utility maximisers (Kaplan and Ruland, 1991;

---

<sup>5</sup> Consequently using ISQC 1 as a 'quality system benchmark' is reasonable given its strong practical focus and the parallels between the requirements of the standard and the prior academic and professional literature, including South African corporate governance standards (Section 1.4.2).

Hill and Jones, 1992). Modern society is, however, far more intricate and unpredictable than economic models based on the assumption of rationality allow for. Complex social and institutional forces are also at work. In this context, Brennan and Solomon (2008) identify the need for alternate perspectives on corporate governance, employing broader theoretical frameworks and notions of accountability (Kaplan and Ruland, 1991; Humphrey, 2008). This is true, even when it comes to the historically portrayed 'neutral' reporting and attest functions of accounting and auditing respectively (Burchell et al, 1980; Hopwood, 1987; Carruthers, 1995).

In keeping with these recommendations, the thesis adopts an institutional perspective of auditing and associated regulatory developments. Section 2.3 and Chapter 6 examine the reporting duty through the lens of legitimacy theory asking: does s45 of the APA accord legitimacy to South African external audit?

Legitimacy is paramount for the continuing existence of organisations, with the result that development of modern organisations can be interpreted, at least in part, by reference to the processes by which organisations seek and maintain legitimacy (Meyer and Rowan, 1977; DiMaggio and Powell, 1983; Suchman, 1995). For the audit profession, where processes and outputs cannot be directly observed, and remain almost 'mystical' in the eyes of non-experts, this may be especially true (Humphrey and Moizer, 1990; Humphrey et al, 1992; Power, 2003). From this perspective, the use of additional external controls over the audit profession may not be totally explained by the drive to improve audit practice and quality. At the heart of the balance between self- and arms-length regulation may be the need to maintain the perceived legitimacy of the audit profession itself, particularly after corporate scandals have impaired the ability of the profession's internally-based reforms to inspire the confidence of stakeholders (Ashforth and Gibbs, 1990; Kaplan and Ruland, 1991; Unerman and O'Dwyer, 2004). Section 45 of the APA is an example of this. As a form of whistle-blowing (Section 2.1.4) which may be contributing to audit quality control systems (Section 2.2; Chapter 4; Chapter 5) and the divulgence of corporate irregularities (Section 2.3; Chapter 6), the reporting duty appeals to notions of acting for the greater good or in the public interest (Nel, 2001; Opperman, 2009). Concurrently, by signalling a move away from a traditional self-regulatory paradigm (Konar et al, 2003; Negash, 2004; Odendaal and De Jager, 2008), the whistle-blowing duty echoes comparable developments both abroad and in other institutional domains which appear to be encouraging arms-length regulation (Gavious, 2007; Canada et al, 2008; Bazerman and Moore, 2011) and whistle-blowing (Vinten, 2000; IOD, 2009; European Commission, 2010b; KPMG, 2011). In doing so, s45 of the APA may be an important source of moral, pragmatic and cognitive legitimacy for the South African Audit Profession.

More critical perspectives are, however, also possible. The RI provisions, just by appealing to formal rational reporting structures backed by statute, may form part of an audit-perception management exercise. What may be more relevant than actual reporting to the IRBA is the simple appearance of a reporting protocol designed to reassure users. In this way, the role of the RI provisions may be the active and influential mobilisation of 'conceptions of reform to the point where regulation *itself* becomes more relevant than the regulated practice' (Hopwood, 1990, p. 84). This may not necessarily be a contradiction of the view that the RI provisions are a genuine source of legitimacy. In complex social environments, claims to legitimacy frequently go hand-in-hand with the careful cultivation of 'institutionalised myths' (Meyer and Rowan, 1977; Fogarty et al, 1991; Suchman, 1995).

In this context, there has been some work on the interconnection between legitimacy and the audit profession. Edwards (2001), Chandler (1993) and Carrington (2010), deal with the relevance of perceptions, the cumulative accomplishments of practitioners, and the importance of professional appearance in contributing to a type of legitimacy reserve. Humphrey et al (1990; 1993b; 2008) and Power (1992; 2003) explore 'auditing rituals' through the lens of legitimacy theory and, most recently, O'Dwyer et al (2011) investigate how claims to legitimacy are used to expand the profession's boundaries. Few studies have, however, examined the interconnection between legitimacy and regulation of the profession, barring isolated exceptions (for example, Fogarty et al, 1991; Fogarty, 1996; Sikka et al, 1998; Malsch and Gendron, 2011). Even then, the prior research tends to be more conceptual, stopping short of carrying out a detailed situation-specific study with the result that more needs to be done in explicating the social context of auditing (Sikka et al, 2009). In addition, these studies, consistent with the criticisms of Brennan and Solomon (2008), have a narrow focus, being concerned almost exclusively with the situation in the USA and Europe.

'We can and have to learn more from the experiences of auditors within and across different firms, contexts and nations' (Humphrey et al, 2011, p. 433). Understanding how s45 of the APA contributes to the legitimacy of the South African audit profession not only provides case-specific support for institutional auditing theorists. Showing how processes of legitimisation at work in an American or European context apply in an African setting assists in developing a conceptual approach to understanding audit regulatory developments mindful of the interconnections between audit practice, the importance of audit quality and claims for legitimacy and how these contribute to the continued existence of the attest function (see Humphrey and Moizer, 1990; Power, 2003; Humphrey et al, 2011). In doing so, the research also adds to the body of whistle-blowing literature which, while discussing the various drivers of and impediments to effective whistle-blowing (Near and Miceli, 1995;

Hwang et al, 2008), stops short of drawing a connection between external audit, whistle-blowing, transparency, accountability and legitimacy (consider Llewelyn, 1996; Llewelyn, 2003). The result is the broader conceptualisation of external regulation of the audit profession which is unrestricted by agency theory, thereby adding to our understanding of mechanisms of accountability, and governance (see Brennan and Solomon, 2008).

Notions of accountability and transparency suggest that s45 of the APA may also give rise to elements of disciplinary power and control (consider Moore, 1991; Roberts et al, 2006). In particular, the presence of Foucauldian 'elements' of enclosure, efficiency and disciplinary power may be relevant for understanding the relationship between the reporting duty and perceptions of underlying quality control systems or claims to legitimacy (Chapter 7).

Despite the institutionalisation of arms-length regulation, the exact characteristics that allow it to restore confidence in the profession in the aftermath of corporate scandals have not been fully explored (Malsch and Gendron, 2011; Tremblay and Gendron, 2011). Section 2.4 and Chapter 7, therefore, provide an initial account of how the prescriptive requirements of s45 of the APA - coupled with sanctions for non-compliance with the reporting duty and motifs of enhanced visibility – reflect Foucauldian power and control. It may be the case that the RI provisions, by rendering a client's transgressions 'visible' and subjecting the auditor to an additional formal reporting requirement, result in 'disciplinary effect' reinforcing any quality gains (Section 2.2; Chapter 4; Chapter 5) or a sense of legitimacy (Section 2.3; Chapter 6). Related to this, Foucauldian 'elements' (Hopper and Macintosh, 1993) may also shed light on how the RI provisions create a valid expectation of more effective reporting by auditors in the name of improved transparency and accountability. While several studies have employed similar techniques in a management accounting setting (Hopper and Macintosh, 1993; Walsh and Stewart, 1993; Brivot and Gendron, 2011), few have done so in an auditing context. Using Foucault's 'technology' of discipline and punishment, therefore, allows for different nuances of audit regulation to be illuminated and further highlights the role of RI's in South African audit.

Ultimately, this thesis is mindful of the body of corporate governance research (Brennan and Solomon, 2008) and, more specifically, research on auditing and audit quality (Francis, 2004). These prior studies are, however, mainly positivist in nature, failing to explicate the complex interaction between social and economic forces (Hopwood, 1987; Carruthers, 1995), especially when it comes to auditing and auditor regulation (Humphrey, 2008). The result is that important mechanisms of accountability are not examined in detail. This is due, in part, to an over-reliance on agency theory (Kaplan and Ruland, 1991; Brennan and Solomon, 2008). Related to this are the influences of the American research establishment

which has favoured quantitative studies over more interpretative or critical accounts<sup>6</sup> (Ahrens et al, 2008; Merchant, 2008). Finally, much of the work on corporate governance is one dimensional. The focus is on studying organisations in a limited number of sectors or by reference to market-observed information. There is also a clear bias in favour of an Anglo-Saxon context (Brennan and Solomon, 2008; Böhm et al, 2013;). Taking this into account, this study is able to make an important contribution by providing a unique insight into corporate governance in Africa. By relying on detailed interviews grounded in agency, legitimacy and power-control theories, the thesis speaks to the need for both methodological and theoretical eclecticism to examine more rigorously a specific element of corporate governance systems while contributing to the debate on the need for external regulation of the audit profession (see Humphrey et al, 2011). Further, this research is the first to deal with the role played by South Africa's RI provisions in the audit arena, despite their being in operation well before democracy in 1994<sup>7</sup>.

---

### 1.3: DEFINITIONS

---

Unless otherwise stated, technical terms have the same meaning as contained in the Glossary of Terms (see also IAASB, 2009b). The following terms are central to the study and are defined here.

- **'Audit'** refers to a professional engagement where the independent practitioner (the **'external auditor'**) expresses a conclusion 'designed to enhance the degree of confidence of intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria' (IAASB, 2009b, p. 2). Only South African-based audits are considered. Further, the thesis deals exclusively with audits of financial statements which are defined as 'reasonable assurance engagements' (IAASB, 2009c). For the sake of brevity, the proposal refers simply to 'audits' or 'external audits' as meaning 'external audits of financial statements'. The audits are 'external' in the sense that they are executed by an independent practitioner with due care and skill (International Federation of

---

<sup>6</sup> The same applies in South Africa where positivist research is far more common than alternative styles (Coetsee, 2011; Maroun, 2012a; Maroun, 2012b).

<sup>7</sup> Special thanks for recommendations on the structure of this thesis must go to the participants at the Critical Perspectives on Accounting Conference (2011); British Accounting and Finance Association Conference (2012); International Corporate Governance Conference (2012); Africa Leads Conference (2012); and King's College London's Doctoral Colloquia (2011; 2012).

Accountants [IFAC], 2006; IRBA, 2011). This research will use the terms audit(or) and external audit(or) interchangeably. In addition, as the auditor will carry out procedures designed to verify certain financial information (IAASB, 2009l; IAASB, 2009m; IAASB, 2009o), this thesis also uses the term **‘attest function’** or **‘assurance engagement (function)’** to refer to an ‘audit’ engagement. These terms are used interchangeably.

- **‘Audit quality control systems’** refers to an audit firm’s policies and procedures which are designed to provide assurance that external audit engagements are carried out to the highest possible standards (Financial Reporting Council [FRC], 2008a; IAASB, 2009x; IAASB, 2009e). These policies and procedures are those described by ISQC 1 and include: (a) leadership responsibilities for quality within the firm, (b) ethical requirements, (c) acceptance and continuance of client relationships and specific engagements, (d) human resources, (e) engagement performance and (f) monitoring (IAASB, 2009x). This thesis will use the terms ‘audit quality control’ and ‘audit quality control systems’ interchangeably. **‘Audit quality control principles’** or **‘audit quality control elements’** refer to the quality control metrics outlined by ISQC 1 collectively. These terms are also used interchangeably.
- **‘Experts’** are individuals cognisant of the detailed requirements of International Standards on Auditing (ISA). They have several years of practical and/or academic experience dealing with auditing at a technical level. Examples include audit partners, academics specialising in auditing and regulators of the audit profession.
- A **‘reportable irregularity’** is: ‘any unlawful act or omission committed by any person responsible for the management of an entity, which -
  - a) ‘has caused or is likely to cause material financial loss to the entity or to any partner, member, shareholder, creditor or investor of the entity in respect of his, her or its dealings with that entity; or
  - b) is fraudulent or amounts to theft; or
  - c) represents a material breach of any fiduciary duty owed by such person to the entity or any partner, member, shareholder, creditor or investor of the entity under any law applying to the entity or the conduct or management thereof’ (s1 of the APA, 2005).

This thesis will refer to the provisions of the APA which mandate the reporting of ‘reportable irregularities’ as ‘s45 of the APA’ or as the ‘reportable irregularity provisions’ or ‘RI provisions’. The terms are used interchangeably.

- **Research quality** is concerned with whether or not research findings are valid and reliable. **‘Validity** and **‘reliability’** refer to ‘contextual’ detail which provides an

indication of the credibility of the evidence and the basis for conclusions (Holland, 2005, p. 250). Going hand-in-hand with this is clearly defining the purpose and scope of the research as well as its inherent limitations to allow the reader to reach his own informed conclusions (Neuendorf, 2002; Ahrens and Chapman, 2006; Parker, 2007; Creswell, 2009). When it comes to interpretive research, validity and reliability are not readily distinguishable and do not have precisely the same meaning as for predominately quantitative studies (Ahrens and Chapman, 2006; Creswell, 2009).

- **‘Respondents’** refers to **‘audit experts’** and **‘informed users’** collectively. This research will use the term **‘respondent’** and **‘interviewee’** interchangeably.
- A **‘user’** (also referred to as an **‘informed user’**) is a user of an audit report who is knowledgeable of audit process in general; has several years of experience dealing with external auditors; and is aware of the regulatory environment in which auditors operate. Examples of ‘informed users’ would include members of audit committees; standard setters; senior financial and risk management officers of organisations; other regulators; or representatives of the Johannesburg Securities Exchange (JSE).
- **Whistle-blowing’** is the disclosure of illegal, immoral or illegitimate practices under the control of one party to an independent third party able to take action (adapted from Miceli and Near, 1984). **‘Whistle-blowing’** includes any form of reporting which challenges the respective party’s power, and which requires the whistle-blower to assess the perceived benefits and costs, even if the act of reporting is obligated by codes of conduct or statute (Rotter, 1966).

---

## 1.4: RESEARCH SCOPE

---

This thesis explores the role of South Africa’s RI provisions in external audit. Three research questions are dealt with:

- A. Do the provisions of s45 of the APA have a perceived impact on the quality control systems of audit firms?**
- B. Does s45 of the APA afford perceived legitimacy to South African external audit?**
- C. Is s45 of the APA an example of surveillance machinery and a manifestation of disciplinary power?**



Each question is informed by the results of detailed interviews with industry experts (Section 3.3) and constitutes the basis for each of the result chapters.

---

### 1.4.1: THESIS STRUCTURE

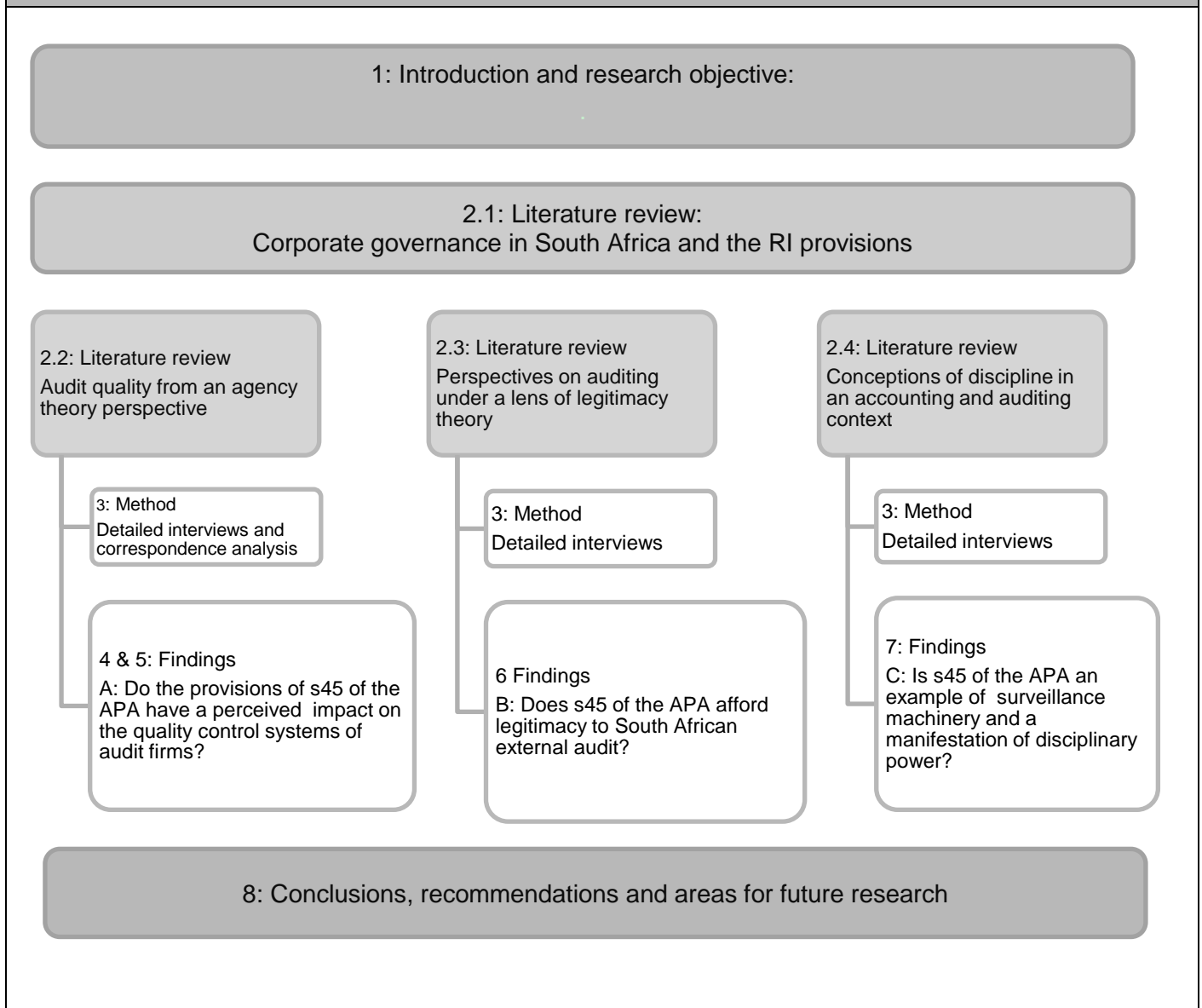
---

This thesis is organised broadly as follows: Chapter 2 grounds the thesis in the prior audit-related research and provides a basis for each of the research questions in Section 1.4. Section 2.1 provides a brief overview of corporate governance in South Africa, including the role of external audit and the RI provisions. Section 2.2 explores audit through the lens of agency theory and includes a review of the prior research on audit quality and the role of external regulation in improving it. Section 2.3 follows with an institutional account of audit practice informed by legitimacy theory. Section 2.4 continues with an interpretive style, examining Foucauldian theory of disciplinary power and its application in an accounting and auditing setting.

Chapter 3 elaborates on the method. Chapter 4 explores the perceived impact of s45 of the APA on audit quality using detailed interviews. Chapter 5 complements the findings in Chapter 4, using a correspondence analysis (Section 3.2) to aggregate and add to the sentiments on the RI provisions' relevance for audit quality. Chapter 6 examines the role of the RI provisions in contributing to the perceived legitimacy of the audit profession, including the possibility of s45 of the APA forming part of a carefully cultivated 'myth' (Meyer and Rowan, 1977) or a sophisticated perception management effort (Suchman, 1995) designed to add to the credibility of the attest function. Chapter 7 expands on this. It draws parallels between the RI provisions and elements of Foucauldian power and control; considers the relationship between motifs of disciplinary power and the legitimisation potential of the reporting duty; and critically evaluates how notions of disciplinary power may contribute to a 'ceremonial display' designed to win stakeholders' confidence and secure the legitimacy of audit practice.

Finally, Chapter 8 provides condensed findings, summarises the key contributions and limitations of the research and identifies areas for additional research, including recommendations. The structure of this thesis is summarised by Figure 1.1 below.

**FIGURE 1.1: THESIS STRUCTURE**



---

### 1.4.2: DELIMITATIONS AND ASSUMPTIONS<sup>8</sup>

---

This thesis should be read in light of the following delimitations: first, the technical details of the RI provisions, being largely procedural in nature (IRBA, 2006), are not extensively examined. Legal issues encountered when interpreting the legislation are also not addressed. Such is a topic of legal debate; is beyond the scope of most audit engagements (IRBA, 2006); and is best suited to a dedicated research effort. A definition of 'reportable irregularity' and guidance on the reporting process is, however, dealt with in Section 2.1 and Appendix A to provide a backdrop for the research.

Secondly, no effort is made to describe fully or to quantify the 'expectation gap' in South Africa. Auditor liability associated with s45 of the APA, as well as the debate on whether or not the auditor has a duty to detect **and** report fraud (Humphrey et al, 1992; Dennis, 2010; Houghton et al, 2011) are **not** specifically addressed. As discussed in Section 1.1, the RI provisions do not create duty to detect fraud (IRBA, 2006). The reporting duty also constitutes only a single aspect of audit practice. Accordingly, the audit expectation gap (Bourne and Minter, 1995; Houghton et al, 2011; Gold et al, 2012), especially in connection with fraud detection and prevention (Humphrey et al, 1993b), is not the focal point of this research. Related to this, the adequacy of legal protection available to auditors; the role of auditor liability in improving audit quality; and legal liability as a manifestation of disciplinary power are only touched on (Chapter 7) to retain the focus of the research on the role played by s45 of the APA in South African audits.

Thirdly, the thesis examines the duty of South African auditors to blow the whistle only per the RI provisions. Other legislation such as the Prevention of Corrupt Activities Act No. 121 of 1998 (POCA) and the Financial Intelligence Centres Act No. 38 of 2001 (FICA) may also give rise to a reporting duty, as may informal reporting requirements such as whistle-blowing hotlines at organisations. These examples of whistle-blowing are normally more restricted in nature and often industry or company specific. The RI provisions are broader (the Public Accountants' and Auditors' Board [PAAB], 2003; IRBA, 2006; PwC, 2006). In addition, due to the fact that s45 of the APA has, to date, applied most often in the context of financial statement audits (IRBA, 2006), the research will not explore the impact of whistle-blowing on other assurance or non-assurance engagements. Concurrently, equivalent foreign legislation is not examined in detail to retain the African perspective of the study and due to inherent

---

<sup>8</sup> This section is included in the Chapter 1 per Creswell (2009) and Leedy and Omerdo (2001) who recommend that the scope of the thesis be defined upfront. A similar approach is followed by the IASB and IAASB.

cost and time constraints. A reproduction of this study in different jurisdictions is deferred for subsequent research.

Thirdly, the study considers mainly the relevance of legitimacy theory and Foucauldian theories of power and control in exploring the case for the RI provisions. Other theoretical perspectives could have been emphasised, for example: theories of moral cognition (Sweeney and Roberts, 1997; Edwards, 2001) or modernity theory (Giddens, 1990; Giddens, 1991). Likewise, the thesis may have been couched predominantly in an agency-theory construct more conducive to quantitative research techniques. The chosen theoretical basis reinforces the study's interpretive style. Furthermore, the purpose of this thesis is not to provide an exhaustive account of every theory that can be used to explain regulatory development in an audit setting or to 'quantify' audit quality pre and post the introduction of the RI provisions. Instead the use of theory is driven by themes emerging from the detailed interviews (Chapter 3) balancing the need for an 'eclectic' use of theory to ensure detailed accounts of the RI provisions (Coldwell, 2012; Humphrey, 2012) with the need for practicality and focus (Llewelyn, 1996; Weetman, 2012)<sup>9</sup>

Fourthly, 'there is no single agreed definition of 'audit quality' that can be used as a standard against which actual performance can be assessed' (FRC, 2006, p. 16). In this context, ISQC 1 is used as a basis for defining 'audit quality control systems' (Section 1.3) similar to other studies that investigate audit quality by using 'quality surrogates' (Fernando et al, 2010; Al-Thuneibat et al, 2011; Daniels and Booker, 2011). Other 'quality criteria' could have been applied. For example, DeAngelo (1981a; 1981b) uses the size of the audit firm as a quality surrogate while Boone et al (2010) use the probability of the auditor issuing a going concern qualification as an audit-quality signal. Using ISQC 1 may run the risk of being taken 'hostage' by professional perspectives and self-serving claims to expertise (Power, 2003, p. 392). Further, the research will be unable to consider the adequacy of the professional standard given that it is used as a basis for describing audit quality control systems. ISQC 1 is, however, applied internationally (Negash et al, 2003; European Commission, 2010a; Boolaky, 2011; Gold et al, 2012). It is similar in substance to equivalent American standards (Bedard et al, 2008) and the essence of principles of sound corporate governance, including South Africa's King Report on Corporate Governance (see FRC, 2008a; IOD, 2009; Solomon, 2010). The standard also reflects the prior auditing research (Section 2.2; Chapter 4) and has been subject to due process and commentary from multiple stakeholder groups. Concurrently it offers a wider 'construct' of audit quality and quality control systems than traditional positivist research has catered for. In turn, this allows the research to provide a

---

<sup>9</sup> Special thanks go to the anonymous reviewers and audience at the British Accounting and Finance Association Conference (2012).

more holistic account of the functioning of audit quality control systems in a real-world setting (Humphrey, 2008; Humphrey, 2012). For this reason, the thesis assumes that the elements of an audit quality control system per ISQC 1 are valid, accurate and complete in all material respects<sup>10</sup>. Ultimately, however, it is not the objective of this research to explore the adequacy of ISQC 1 in detail.

Fifthly, the thesis relies on detailed interviews with both informed users **and** experts (Section 3.3) to provide a **holistic** account of the role of the RI provisions. The main objective of this research is not to explore variations in perceptions of experts from large and smaller audit firms with an aim to concluding on the effect of firm size on audit quality. Likewise, this research does not explicitly deal with describing and quantifying the audit expectation gap as discussed above (Humphrey et al, 1992; Gold et al, 2012). For this reason, detailed analysis of differences in opinions between users and experts is not carried out<sup>11</sup>. Where obvious differences in the views of experts at large or smaller firms, on the one hand, or users and experts, on the other, emerge, these are dealt with only to add to an overall understanding of the role of the RI provisions.

On a final note, despite safeguards to reduce threats to validity and reliability to acceptably low levels (Chapter 3), these threats cannot be totally eliminated. Inevitably, there is the assumption that research participants acted with integrity, objectivity and due care when providing their responses and that they provided complete and accurate accounts<sup>12</sup> (Alvesson, 2003; Creswell, 2009; O'Dwyer et al, 2011).

---

<sup>10</sup> What Power (2003) does not discuss is the possibility of being taken 'hostage' by the arguably 'closed' perspectives of top-rated international journals. Jones et al (2006), for example, highlight the presence of 'invisible colleagues' and 'network groups' with links to editorial boards of one such journal and how the majority of articles come from a consistent group of authors representing only a handful of tertiary institutions. Consequently, one cannot automatically assume that using a professional standard to define 'audit quality' is necessarily more of a validity threat than relying exclusively on formal academic publications from the leading journals. What should also be born in mind is that 'peer review' involves a limited number of academics only. It is not equivalent to due process followed by the IAASB involving multiple stakeholder groups unobscured by anonymity. In light of the views of Power (2003) and Jones (2006), this thesis uses perspectives on audit quality and audit quality control systems drawn *both* from the academic *and* professional literature.

<sup>11</sup> This would also be inappropriate given the relatively small sample sizes and that fact that, unlike most expectation gap studies that draw on the opinions of multiple stakeholder groups (Gold et al, 2012; Porter 2012), this paper concentrates on subject experts rendering an analysis of the expectation gap moot. Together with small sample sizes, this also makes drawing conclusions on the distinctions between large and smaller firms problematic.

<sup>12</sup> As discussed in Chapter 4, Chapter 5 and Chapter 6, interviewees provided detailed accounts of their experiences with and perceptions of s45 of the APA which relate to the prior academic work on auditing. At the same time, several accounts are highly critical of the auditing or regulatory establishment and seldom are views on the whistle-blowing duty precisely the same. This implies that the risk of rehearsed accounts or responses motivated by the desire to provide the politically or socially correct 'answer' (Alvesson, 2003), has been adequately managed by the researcher.

## **2: EXTERNAL AUDITS AND WHISTLE-BLOWING**

---

Chapter 2 reviews certain of the prior audit-related literature. The aim is not to provide a complete account of the research on auditing, auditing quality and audit quality control systems but rather to provide a context for this thesis. To this end, Section 2.1 provides a brief overview of corporate governance developments in South Africa, including audit-specific reforms. This includes a summary of the history and operation of the South African auditor's whistle-blowing duty. Section 2.2 follows with an agency theory perspective on audit and introduces the first research question dealing with the association between the RI provisions and audit quality. Section 2.3 identifies the need for more institutionally orientated research in accounting and auditing and derives the second research question dealing with s45 of the APA as a possible source of legitimacy for the audit profession. Finally, Section 2.4 continues with the exploration of interpretive and critical audit research, examining the prior accounting research employing a Foucauldian theoretical lens and, by analogy, asks if the RI provisions may be reminiscent of Foucault's model of disciplinary power and control.

### **2.1: CORPORATE GOVERNANCE IN SOUTH AFRICA, EXTERNAL AUDIT AND THE RI PROVISIONS**

---

#### **2.1.1: A BRIEF HISTORY OF SOUTH AFRICAN CORPORATE GOVERNANCE**

---

Following democracy in 1994, international investment in South Africa began to increase, as did the number of incorporated companies and organisations listed on the JSE (Rossouw et al, 2002). In ensuring the sound functioning of this growing capital market, South Africa chose a broad corporate governance strategy that relied on a mix of external regulation complemented by professional codes and codes of best practice. For example, exchange controls, prohibitions on certain listing structures and restrictions on the trading of certain financial instruments have been commonplace (Rossouw et al, 2002; West, 2006). Company Law has also traditionally sought to regulate the relationship between shareholders, directors and corporations (Companies Act, 1973). In 1994, these measures were complemented by the introduction of King-I (IOD, 1994). King-I, in addition to financial and regulatory aspects of corporate governance, advocated a more holistic outlook on firm leadership which

stressed the importance of financial and ethical dimensions of the corporate governance landscape. King-I was not in response to any one particular corporate failure but rather identified the need to align South African business practice with international governance standards following political emancipation and to take cognisance of a number of prevailing social and economic ills (Vaughn and Ryan, 2006; Diamond and Price, 2012). Recognising the need for greater economic participation following Apartheid, the focus was on simplified, but high quality, financial reporting and on the principles of transparency, accountability and ethical, all-inclusive, business (IOD, 1994; Rossouw et al, 2002; Hamann et al, 2005).

As such King-I (1994), entrenched the responsibility of a unitary board for ensuring financial reporting that met the information needs of users and maintaining an effective system of monitoring and control to safeguard an organisations' assets. As part of this, it stressed the importance of external audit as a means of providing assurance on the fair presentation of financial statements and underlying controls. In addition, echoing the Cadbury Report (Solomon, 2010), King-I recommended that companies form audit committees which would assist with, inter alia, managing the relationship between the external auditor and management to ensure high levels of auditor independence.

South Africa's first democratic election was not a cure for the effects of almost sixty years of political and economic isolation (Hamilton et al, 2009; Diale, 2012). Adding to this was the Russian-Brazil-Asian financial crisis of 1997/1998 which heightened risk aversion towards developing economies (Vaughn and Ryan, 2006; Diamond and Price, 2012). Political and economic uncertainty, however, gave way to greater involvement by the country on the international stage and a period of fiscal growth. Integration into world markets also meant that South Africa became more susceptible to varying trends and changing sentiments in foreign jurisdictions (Rossouw et al, 2002; Vaughn and Ryan, 2006). For example, the evolution from a shareholder-centric view of corporate governance to broader conceptions of the interests of multiple stakeholder groups and relevance of non-financial reporting (Brennan and Solomon, 2008; Christopher, 2010; Solomon, 2010) taking hold in the UK had a direct impact on South African corporate governance developments (IOD, 1994). Being a developing economy heavily dependent on international capital and eager to demonstrate its legitimacy as an international player, South Africa was quick to refine its existing governance principles to echo sentiments abroad and allow it to take a leading role in the corporate governance arena (Rossouw et al, 2002; Konar et al, 2003; Vaughn and Ryan, 2006; Solomon, 2010; King, 2012).

In this context, King-II (2002), proposed a move from a narrow view on firms' performance to more inclusive, 'triple-bottom-line' reporting. Changes concerned, for example, the role and

function of the board of directors and company officers, information technology, risk-management and social, health and environmental reporting. In particular, the need for sound audit services was dealt with to ensure the continued relevance of the attest function and reliability of annual reports (IOD, 2002; Rossouw et al, 2002; Puttick and van Esch, 2003; Diamond and Price, 2012)<sup>13</sup>. King-II continued with a principles-based approach, being strongly influenced by codes of governance in the UK, particularly the importance of a broader focus on stakeholder interests (West, 2006; Solomon, 2010). Revisions also took cognisance of corporate failures both domestic and abroad, as well as an increase in both the volume and level of complexity of economic transactions (Nel, 2001; Deker, 2002; West, 2006; Maroun, 2012c). During 2009, the global financial crisis, persistent socio-economic inequality, resource constraints, climate change and mounting allegations of corruption in the public sector led to the release of King-III and the world's first discussion paper on integrated reporting (IOD, 2009; IRC, 2011; King, 2012; Payne, 2012). These placed a renewed emphasis on the need for balanced, holistic reporting (integrated reporting) that takes cognisance of both financial and non-financial measures and communicates their interconnection with a company's ability to create and sustain value responsibly in the short-, medium- and long-term (Solomon and Maroun, 2012).

In this way, codification of the country's first governance practices in 1994 signals a growing awareness of the need for holistic leadership that is in the interest of more than just capital providers. The ever-changing economic and regulatory environment leads to King-II in 2002 with its emphasis on triple-bottom-line reporting. Finally, 2009 marks the beginning of an 'integrated reporting' paradigm where, faced with mounting social, economic and environmental pressures, sound governance necessitates new and innovative ways of doing business and of communicating both benefits and risks to varied and dispersed stakeholder groups (IRC, 2011; King, 2012). Despite considerable variations in the scope and emphasis of South Africa's codes of corporate governance, what has, however, remained a common feature is the role of external audit in providing assurance, whether in connection with the then annual report or, at present, the first sets of integrated reports.

---

<sup>13</sup> While King-II had a more 'inclusive' approach than King-I, it continued to stress the importance of the shareholder, capital and generation of reasonable returns (West, 2006; Diamond and Price, 2012).



---

## 2.1.2: AUDITING IN SOUTH AFRICA

---

Early references to some form of attest function can be traced to Ancient Egyptian, Babylonian, Greek and Roman societies where systems of checks and balances were put in place over government administrators, including tax and grain collectors (Nel, 2001; Puttick and van Esch, 2003). With the separation of manager and owner functions giving rise to the need for clear, honest accounting by agents to principals, more formal practices aimed at providing assurance over statements of accounts began to take hold (Watts and Zimmerman, 1983). The emergence of the Joint Stock Company and Industrial Revolution provided an added impetus to the development of modern audit practices (Watts and Zimmerman, 1983; Chandler et al, 1993; Edwards, 2001). The subsequent proliferation of companies (Coase, 1937; Watts and Zimmerman, 1983); widening 'distance' between shareholders and agents (Jensen and Meckling, 1976); and growing recognition of the interests of multiple stakeholder groups (Solomon, 2010; International Integrated Reporting Committee [IIRC], 2011; IRC, 2011) have simply stressed the need for ever-more sophisticated attest procedures to provide assurance over financial reports. While auditing has changed substantially from ancient times, the fundamental principle on which it is based has, however, remained relatively constant: 'men in positions of trust should be subject to public scrutiny' and, thus, a form of control is needed to ensure that 'stewards [are] more honest' (Nel, 2001, p.121).

In South Africa, in line with earlier changes occurring in the UK, the formation companies and emerging agency problem gives rise to the early South African Accounting Profession and mandatory audit for companies (Puttick and van Esch, 2003). In 1894, The Institute of Accountants and Auditors and Auditors in the South African Republic, was formed influenced heavily by the Institute of Chartered Accounts in England and Wales (ICAEW) established in 1880 (Nel, 2001). Following the Boer Wars, various provincial accounting bodies emerged which were partially unified following the establishment of a country-wide set of examinations; regulations to control entry to the profession; and the passing of the Chartered Accountants Designation (Private) Act No. 13 of 1927<sup>14</sup> (Puttick and van Esch, 2003). In 1946, the Joint Council of Societies of Chartered Accountants of South Africa was constituted, later renamed the National Council of Chartered Accountants (SA) in 1966. It was not until 1951, however, that formal legislation aimed specifically at the auditing profession was introduced with the promulgation of the PAAA (Nel, 2001) which provided for,

---

<sup>14</sup> This legislation, which is still in effect, allows the use of the designation: *Chartered Accountant (South Africa)* or CA(SA).

*inter alia*, the registration of auditors<sup>15</sup>, and the formation of the PAAB. The PAAB was intended to serve the public interest by ensuring high standards of audit quality - including auditor independence - through various regulatory efforts (Nel, 2001; Puttick and van Esch, 2003). In 1980, this was complemented by the provincial accounting bodies, under the National Council of Chartered Accountants, being superseded by a single member-body: the South African Institute of Chartered Accountants (SAICA) with an aim to, among other goals, improve the quality of South African accounting and auditing, and bolster the standing of the profession.

Today, in South Africa, audits are mandatory for all listed companies and for those companies with a sufficiently high public interest score (Companies Act, 2008). South African audits are carried out in accordance with ISA. Briefly, these require the auditor to express an opinion on whether or not a client's financial statements are prepared in all material respects in accordance with the applicable reporting framework<sup>16</sup> (IAASB, 2009c; IAASB, 2009e; IAASB, 2009g; IAASB, 2009h) and the Companies Act (2008) (IAASB, 2009ab; IRBA, 2009a; IRBA, 2009b). In discharging this duty, the auditor ought to assess the risk of misstatement due to fraud and error, including non-compliance with relevant laws and regulations. He should design and execute audit procedures to reduce this risk to acceptably low levels. This should not, however, be construed as implying that the auditor has an active duty to seek out every fraud or legal transgression (IAASB, 2009g; IAASB, 2009h). In addition, ISA – read with the codes of professional conduct (IFAC, 2006; IRBA, 2011) – require the auditor to maintain client confidentiality. Barring a modification of the audit report, and in the absence of a legal duty to the contrary, the auditor is, therefore, effectively prohibited from divulging client information (PAAB, 2003; IRBA, 2006; IAASB, 2009h; FRC, 2011). This could lead to a peculiar situation where actions of a client, even if contrary to the public interest, or relevant for assessing the organisation's commitment to sound governance, would not be communicated to stakeholders unless it had a material impact on the financial statements and resulted in a modified audit report.

As discussed in Section 2.1.1, South Africa has taken the position that a system of checks and balances over companies is a defining part of the local market. The existing tension between the duty of client confidentiality and need to inform relevant stakeholders of potentially significant irregularities stands in stark contrast with this. The South African Government, therefore, took the position in the late 1950's that '...an auditor owes a duty not

---

<sup>15</sup> In terms of the PAAA, only 'registered auditors' (RAs) were permitted to express an opinion on a client's financial statements. Presently, a similar situation holds (IRBA, 2011).

<sup>16</sup> In South Africa, this would most commonly be IFRS or IFRS for Small and Medium-Sized Entities.

only to his client but also to the public' (Minsiter of Finance of the Republic of South Africa, 1951 cited in Nel, 2001) and that consequently, arms-length regulation aimed at clarifying an auditor's reporting duties would prove instrumental in enhancing the perceived quality of what was being reported by auditors and, hence, the confidence vested in the audit profession and local capital markets<sup>17</sup> (Dunn et al, 1989; Nel, 2001; Konar et al, 2003; van Esch et al, 2004).

Economic growth, social and political unrest, and increasing globalisation led to calls for a more holistic or comprehensive system of regulation (Odendaal and De Jager, 2008; Diamond and Price, 2012). As discussed above, South Africa replied with the introduction of King-I, and later King-II, which introduced several reforms and confirmed the country's reliance on a hybrid system of corporate governance based on a combination of codified best practices and statute (IOD, 1994; IOD, 2002; King, 2012). The same was true in an audit context where codes of professional conduct and audit practice, coupled with the PAAA, served as the primary basis for regulating the activities of the profession (Nel, 2001; Puttick and van Esch, 2003). The early part of the twenty first century, however, saw material threats to the profession's largely self-regulatory franchise. A number of corporate scandals occurring during the 1990's and early 2000's led to a 'crisis of confidence in the auditing profession, and to serious questions being asked about the integrity of the financial reporting system and the quality and usefulness of information it generates' (Odendaal and De Jager, 2008, p. 1). At a global level, the fall of Enron and Arthur Anderson led to calls for additional reforms and investor protection (Malsch and Gendron, 2011; Tremblay and Gendron, 2011) with the ripple effects amplifying local debacles at, *inter alia*, Masterbond, LeisureNet and Saambou, and stimulating calls for further arms-length control over the profession (Nel, 2001; Manuel, 2002; Odendaal and De Jager, 2008). This development should also be seen against the backdrop of powerful forces of isomorphism (DiMaggio and Powell, 1983) which necessitated that local governance-based reforms mirror the proliferation of new laws and regulations in leading economies and, not by coincidence, some of the country's most important trade partners and providers of capital (Rossouw et al, 2002; West, 2006; King, 2012).

In this context, South Africa took steps to harmonise its accounting and auditing standards with International Financial Reporting Standards (IFRS) and ISA respectively, simultaneously revising its auditor codes of ethics and conduct. To add to these largely self-regulatory efforts, amendments to Company Law mandated certain auditor independence

---

<sup>17</sup> The Government stopped short, however, of imposing a fraud detection duty on auditors on the grounds that this would be impractical (Nel, 2001) and instead required certain irregularities, if detected during an audit, to be reported to the PAAB as discussed below.

requirements, echoing changes seen in Europe and, in particular, the USA (Konar et al, 2003). For example, the principle of partner rotation as an auditor independence safeguard was historically dealt with only in terms of codes of professional conduct. The same was true of the need to manage the nature and extent of non-audit services rendered to an audit client (Puttick and van Esch, 2003). Section 92 of the Companies Act (2008) now imposes mandatory five-year rotation rules. Similarly, s93(3)a of the Companies Act, read with s44(6) of the APA, effectively restricts the rendering of non-audit services. While not as prescriptive as comparable requirements found in SOX (Riotto, 2008), the effect is, in substance, a prohibition on offering services to an audit client which would be construed as leading to a material 'conflict of interest' in the eyes of the IRBA (s44(6) of the APA). Analogously, the role of audit committees as part of the corporate governance system, particularly in assisting with the preservation of auditor independence, is no longer the sole domain of King-III. Section 94(7) of the Companies Act legislates a number of committee duties reminiscent of those found in SOX. With regards to the auditor in particular, these include, ensuring that the auditors do not render non-audit services that would compromise their independence; determination of auditor fees; and nomination and appointment of the auditor.

In addition, the APA<sup>18</sup> was promulgated. At the same time that the auditor peer review system in the USA was being challenged (Carcello et al, 2011; Malsch and Gendron, 2011), concerns were raised about the PAAB. Being funded and constituted by members of the profession, critics argued that it lacked the objectivity needed to regulate the audit profession effectively and was tainted by a perception of being reluctant to discipline its members. Under the APA, the IRBA, therefore, superseded the PAAB. Unlike its predecessor, the IRBA was vested with powers of inspection to add to the credibility of the audit review process bolstered by legislated sanctions for delinquent auditors that could be applied more broadly than under the PAAA. The IRBA would also have a more diverse board<sup>19</sup> and enjoy multiple sources of funding (Konar et al, 2003; Odendaal and De Jager, 2008; IRBA, 2012a). In this way, rather than be concerned only with the interests of its members (Konar et al, 2003), s2 of the APA expressly calls for the IRBA to protect the public interest (Konar et al, 2003; Odendaal and De Jager, 2008).

On the back of these changes, a statutory requirement under the PAAA, in terms of which auditors were obliged to blow the whistle on certain client transgressions, was revised and firmly entrenched as a part of audit practice (Dunn et al, 1989; PAAB, 2003; IRBA, 2006). As

---

<sup>18</sup> The promulgation of the APA marks an increase in external regulation over the audit profession and serves as an example of how South Africa applies a 'hybrid' approach to governance, relying on a mix of regulation, professional standards and voluntary codes such as King-III (Diamond and Price, 2012; King, 2012).

<sup>19</sup> Not more than 40% of the board may be auditors (IRBA, 2012a).

discussed in Section 1.1, historically low levels of reported irregularities under the PAAA were interpreted as a stumbling block to enhanced corporate transparency and a possible indicator that auditors lacked the independence needed for blowing the whistle on their clients. Consequently, in 2005, the APA broadened the reporting requirements, introducing penalties for non-compliance with the reporting duty (Nel, 2001; Opperman, 2009). Since then, the requirement to bring 'reportable irregularities' to the attention of the IRBA has been described as an important mechanism by which regulation contributes to a culture of compliance with laws and regulations by corporates, aiding in the reduction of white collar crime (Opperman, 2009). Simultaneously, it has been cited as a viable means of further integrating audit with existing processes of accountability (Nel, 2001) – a theme featuring strongly in codes of corporate governance seeking to entrench ideals of transparency, ethics and sustainability (IOD, 2009; Solomon, 2010). That this whistle-blowing duty is making a valuable contribution is supported by an excess of 3 000 reports to the regulator to date dealing with, *inter alia*, contraventions of the Companies Act, tax irregularities, estate agency contraventions, non-compliance with JSE rules, departures from labour laws and fraud (Wielligh, 2007; Opperman, 2009). Accordingly, proponents of the whistle-blowing duty argue that it represents a 'step in the right direction if Government wishes to protect the financial interests of investors...the public at large, and ultimately the integrity of [local] financial markets' (Opperman, 2009, p. 29) while simultaneously adding to the quality of audit reports and value-adding potential of the attest function (Nel, 2001).

In this thinking, the South African Legislature was not alone. Calls for improved reporting by the auditors has been a topic of considerable debate by the European Community as evidenced by the European Commission's (2010b) green paper on audit quality. Similarly, the UK, USA, France, Denmark, Norway and Sweden are among the various jurisdictions where auditors may be required to bring certain client conduct to the attention of third parties (Humphrey et al, 1993b; Nel, 2001; American Institute of Certified Public Accountants [AICPA], 2007; Brennan and Kelly, 2007; Kaplan and Schultz, 2007; Vakkur et al, 2010; Porter et al, 2012). What makes the South African context unusual is that that the imposed whistle-blowing duty is a broad one. It does not apply only in a financial services setting, in the public sector, or merely in terms of professional standards (Nel, 2001; Maroun and Gowar, 2013). Instead, the auditor is required to consider all information coming to his attention from any source when deciding whether or not suspected 'reportable irregularities' ought to be brought to the IRBA's attention (PwC, 2006; Wielligh, 2006).

---

### 2.1.3: THE REPORTABLE IRREGULARITY PROVISIONS

---

The PAAA is the genesis of the South African auditor's mandatory duty to bring certain transgressions to the attention of, then, the PAAB. In terms of s20 (5) of the PAAA:

'If any person acting in the capacity of auditor to any undertaking is satisfied or has reason to believe that in the conduct of the affairs of such undertaking a material irregularity [MI]<sup>20</sup> has taken place or is taking place which has caused or is likely to cause financial loss to the undertaking or to any of its members or creditors, he shall forthwith dispatch a report in writing to the person in charge of that undertaking giving particulars of the irregularity....' (s20(5)a of the PAAA).

Having issued the initial report,

'[unless] within 30 days after an auditor has dispatched such a report, he has been satisfied that no such irregularity has taken place or is taking place or that adequate steps have been taken for the recovery of any such loss so caused or for the prevention of any such loss likely to be so caused, he shall forthwith furnish the [Public Accountants' and Auditors' board - an independent regulatory board] with copies of the report and of any acknowledgement of receipt thereof and reply thereto and such other particulars as he may deem fit' (s20(5)b of the PAAA).

In this way, the PAAA established what may be broadly defined as a whistle-blowing duty for South African external auditors (Section 2.3; Chapter 6). In 2001, the *Commission of Inquiry into the Affairs of the Masterbond Group and Investor Protection in South Africa* (2001), proposed a number of refinements to this whistle-blowing duty. As discussed in Section 2.1.2, in 2005 the APA superseded the PAAA and, *inter alia*, replaced the requirement for auditors to report 'material irregularities' (s1 of the PAAA, 1951) to the PAAB with the duty to inform the IRBA of 'reportable irregularities' (RI's) (s1 and s45 of the APA, 2005).

Briefly, any 'unlawful act or omission' by a person responsible for a client's management (s1 of the APA, 2005; Appendix A1) (its management board) which has caused or is likely to cause material financial loss to different stakeholders; amounts to a material breach of fiduciary duty; or is an act of theft or fraud, must be reported 'without delay' to the IRBA (s45 of the APA, 2005; IRBA, 2006; Appendix A1; Appendix A2). Like the PAAB, the IRBA is empowered to inform appropriate regulators of the irregularity (PAAB, 2003; IRBA, 2006; Appendix A3). The reporting duty under s45 of the APA is largely consistent with that under

---

<sup>20</sup> The PAAA did not specifically define a 'MI'. According to the PAAB (2003, p. 11), an 'irregularity [would have arisen] from a breach of statutory provisions, the common law or the undertaking's own constitution' which had a material impact on shareholders and creditors.

the repealed s20(5) of the PAAA (Gawith, 2006; PwC, 2006; Wielligh, 2006). Three important difference expanding the scope of the reporting duty should, however, be noted.

Firstly, the auditor suspecting a MI was first obliged to notify the client. It was only if, within 30 days after informing the client, that the PAAB was notified of the irregularity and then only if the client had not responded appropriately to the respective transgression (Dunn et al, 1989; PAAB, 2003). Fearing that auditors' professional judgement could lead to inconsistent application of the whistle-blowing duty, or that auditors and clients would use the 30-day period to circumvent the need for the reporting, the 30 day window period was dispensed with in favour of reporting 'without delay' (Nel, 2001; Gawith, 2006; Wielligh, 2006). Therefore, within three days of the IRBA being informed (and not before) the auditor must notify the client of the suspected RI and afford the management board a reasonable opportunity to discuss the first report with the auditor (s45(2) of the APA, 2005). In addition, a second report sent to the IRBA - 30 days after the first report - is now more informative, divulging that either: no RI occurred; an RI did occur but has been remedied; or that the RI is continuing (IRBA, 2006; Appendix A1; Appendix A2).

Secondly, and along similar lines, it was resolved that any act of theft or fraud involving those responsible for the management of the client, irrespective of perceived materiality, would be reportable to the IRBA (IRBA, 2006; PwC, 2006). This was despite the possibility of proliferation of clearly trivial reporting (SAICA, 2001 cited in Nel, 2001; Wielligh, 2006) which the legislature felt would be outweighed by the added benefit of more frequent whistle-blowing (Nel, 2001). Similarly while breaches of fiduciary duty and acts or omissions leading to financial loss would continue to be reportable only if material, these losses or breaches need not only be suffered by 'members or creditors' of the audit client to be reportable (s20(5) of the PAAA). The effects on a 'partner, member, shareholder, creditor or investor' would now also have to be considered (s1 of the APA) thereby further broadening the reporting duty (IRBA, 2006; PwC, 2006; Wielligh, 2006).

Finally, s20(5) of the PAAA usually applied only in cases where the auditor was *acting* in the capacity of an auditor to any undertaking (PAAB, 2003). Under s45 of the APA, a reporting duty can arise simply if one is the registered auditor of the entity, irrespective of the capacity in which the auditor is operating. This, together with the definition of an 'audit' under s1 of APA can potentially result in review (IAASB, 2009y; IAASB, 2009z) or other assurance engagements (IAASB, 2009u; IAASB, 2009v) also giving rise to a duty to report under s45 of the APA (IRBA, 2006; Maroun and Wainer, 2013; Appendix A5).

In this way, the APA marked the entrenchment and widening of the auditor's whistle-blowing duty (Nel, 2001; Wielligh, 2006 SAICA, 2001 cited in Nel, 2001). As discussed in Section 1.1 and Section 2.1.2, the South African Government feared that the historically low volume of MI's being reported to the PAAB were indicative of ineffective whistle-blowing policies that could be enhanced if the reporting duty was broader<sup>21</sup> (Manuel, 2002). It would then be left to an independent regulator to conclude on whether or not the irregularity ought to be brought to the attention of the relevant third parties, rather than leaving this decision in the hands of the individual auditor (Nel, 2001). To ensure more active reporting, the APA makes non-compliance with the s45 of the APA an offence, leading to professional sanctions and fines, imprisonment or a combination of both<sup>22</sup> (IRBA, 2006).

By actively promoting the reporting of transgressions, Government was of the opinion that the RI provisions would improve corporate transparency and accountability, contributing to a culture of compliance among audited entities (Nel, 2001; Opperman, 2009; IRBA, 2012b), consistent with the views on whistle-blowing in general (Vinten, 2000; Vinten, 2003; Nam and Lemak, 2007; Hwang et al, 2008; Reckers-Sauciuc and Lowe, 2010; Seifert et al, 2010). At the same time, expanding the reporting duty resonated with the growing demands for improved auditor reporting in the context of corporate failures and an increased awareness of the need to meet the information expectations of multiple stakeholder groups (CESR, 2007; Solomon, 2009; European Commission, 2010a). As such, it was hoped that s45 of the APA would, ultimately, contribute to the overall standing of the South African Audit Profession in the eyes of constituents.

---

#### **2.1.4: WHISTLE-BLOWING BY EXTERNAL AUDITORS IN SOUTH AFRICA**

---

The relationship between s45 of the APA; the act of divulging transgressions; and the issue of audit's public responsibilities begs the question: is s45 of the APA an example of whistle-blowing? Miceli and Near (1984, p. 824) define 'whistle blowing' as:

---

<sup>21</sup> This view was reaffirmed by the regulator. According to personal correspondence between the researcher and the IRBA, the introduction of s45 of the APA saw a significant increase in the number of irregularities reported from 'only a handful' to an average of 850 per annum over the last five years. Specific details on each reported irregularity were not made available to the researcher due to the need of the IRBA to protect the confidentiality of the parties involved (IRBA, 2012b).

<sup>22</sup> Section 20(8) of the PAAA simply empowered the PAAB to impose professional sanctions on an auditor failing to perform his duties. It did not deal specifically with a contravention of s20(5) of the PAAA and did not explicitly criminalise non-compliance with the reporting duty.



'The disclosure by 'organization members... of illegal, immoral or illegitimate practices under the control of the employer to persons or organizations who may be able to effect action.'

The act should not be motivated only by self-gain and should be for the greater good (Leeds, 1963; Shotland and Huston, 1979; Near and Miceli, 1995; Vinten, 2000; Kaplan and Schultz, 2007; Hwang et al, 2008). Using a 'pro-societal' model of behaviour, Staub (1978), Solano and Kleiner (2003) and Hwang et al (2008) explain that the whistle-blower probably seeks to ensure that positive societal behaviour prevails against the backdrop of maximizing utility for others, including himself. This implies that a fear of retaliation and sense of being removed from a transgression can lead to reduced incidents of whistle-blowing, even if reporting is in the best interests of society (Rotter, 1966; Latane and Darley, 1968; Dozier and Miceli, 1985; Roberts, 1991; Schultz et al, 1993; Brennan and Kelly, 2007; Reckers-Sauciuc and Lowe, 2010).

Jubb (1999) has a similar definition although there are three differences. Firstly, he excludes internal reporting as an act of whistle-blowing. This argument is, however, refuted by Brennan and Kelly (2007) and Mitschow and Langford (2000) who argue that both internal and external reporting challenges authority and involve similar processes. Secondly, while Near and Miceli (1984) allude to the gravity of the reported improprieties, Jubb (1999) explicitly requires the wrong-doing to be 'non-trivial'. Finally, Jubb's (1999) definition stresses that the act of whistle-blowing should be non-obligatory although Rotter (1966) maintains the contrary on the grounds that even obligatory reporting challenges organisational power and requires the whistle-blower to assess the perceived benefits and costs.

Considering the RI provisions, compliance with legislation amounts to the disclosure of otherwise confidential client information to the IRBA which is vested with authority to inform all interested third parties of the irregularity (IRBA, 2006). In this respect, although Near and Miceli (1984; 1995) refer specifically to divulgements made in an employer-employee context, the substance of reporting in both instances is consistent. Concurrently, the requirement for 'unlawful acts' or 'omissions' to be fraudulent or a material breach of fiduciary duty or trust (s1 of the APA) points to divulgence of more than trivial misconduct. Although compliance with the legislation allows avoidance of fines, imprisonment and ethical sanctions, the auditor receives no compensation for reporting (Nel, 2001; IRBA, 2006; IRBA, 2011, s45 & 52 of the APA). This implies an absence of self-gain. In addition, s45 of the APA was introduced, in part, to combat impropriety, bringing transgressions to the attention of appropriate authorities with an aim of remedying wrong-doings (Nel, 2001; IRBA, 2006). This parallels the notion of whistle-blowing influencing change for a perceived greater good (Near and Miceli, 1995; Kaplan and Schultz, 2007) and is consistent with Rotter (1966), Dozier and Miceli (1985),

and Jacques (1961) who maintain that reporting - even if mandated by professional standards or statute - could still amount to whistle-blowing. Further, altruism beyond explicit legal requirements is not a prerequisite for disclosing 'reportable irregularities' to amount to whistle-blowing (see Hwang et al, 2008). Finally, the absence of direct legal protection offered by the APA for the auditor who, having reported an RI and now possibly faces a delictual<sup>23</sup> or breach of contract claim (IRBA, 2006; Maroun and Gowar, 2013) implies that, as with 'traditional' acts of whistle-blowing, a sense of 'fear of retaliation' is present (Kaplan and Whitecotton, 2001; Brennan and Kelly, 2007; Reckers-Sauciuc and Lowe, 2010).

For these reasons, the RI provisions are consistent with Miceli and Near's (1984) notion of 'whistle-blowing'. Although not occurring in an employer-employee context, the legislation requires what would amount to 'illegal, immoral or illegitimate practices' under the control of another to be reported to a third party, in this case, the IRBA, who is able to take action. The reporting duty, although obligatory, challenges organisational power in a similar fashion to voluntary reporting by employees and can give rise to comparable fear of retaliation that requires the whistle-blower to assess the perceived benefits and costs of reporting. Barring semantics, s45 of the APA is, therefore, an example of whistle-blowing for the purpose of this research<sup>24</sup>.

The prior literature on whistle-blowing, however, tends to deal mainly with defining 'whistle-blowing' (Miceli and Near, 1984; Near and Miceli, 1995; Jubb, 1999) or illuminating the processes involved in deciding whether or not to blow the whistle (Leeds, 1963; Miceli and Near, 1984; Jubb, 1999; Nam and Lemak, 2007; Reckers-Sauciuc and Lowe, 2010). Some work has been done on whistle-blowing in an internal audit setting (Read and Rama: 2003). Brennan and Kelly (2007) and Kaplan and Whitecotton (2001) also shed light on whistle-blowing by subordinates in an external audit environment. Virtually no research, however, has been carried out on *external* auditors blowing the whistle on their clients. This is despite the increased attention on the need for auditors to, in addition to providing an opinion on a client's financials, disclose further information obtained during the course of their audits on the state of compliance with laws and regulations and overall culture of governance at their clients (Solomon, 2009; European Commission, 2010b; King, 2012).

---

<sup>23</sup> A 'delict' is wrongful or culpable conduct which causes harm to a person, property or personality of another (Maroun and Gowar, 2013).

<sup>24</sup> Whether or not the RI provisions are exactly aligned with formal definitions of 'whistle-blowing' is not specifically the focus of this thesis. What is, however, important is that several respondents, discussing their perceptions of s45 of the APA, specifically refer to the RI provisions as tantamount to whistle-blowing and draw parallels between these provisions and other documented cases of whistle-blowing. The resulting connotations of the RI provisions being associated with whistle-blowing sheds light on s45 of the APA as a possible source of improved audit reporting quality and auditor legitimacy as discussed in detail in Chapter 4 onward.

Looking specifically at s45 of the APA - as an example of whistle-blowing - what is not immediately apparent is the role of the regulatory duty in South African audit. The Nel Commission (2001) presents the RI provisions as a means of clarifying the auditors' societal duty in connection with reporting transgressions. Similarly, the prior literature would imply that the reporting duty is an example of pro-social behaviour (Staub, 1978; Miceli and Near, 1984; Near and Miceli, 1995) which, by divulging irregularities, improves transparency and, thus, adds to the perceived value and standing of the audit process (consider: Vinten, 2000; Vinten, 2003; CESR, 2007; Nam and Lemak, 2007; Hwang et al, 2008; Solomon, 2009; European Commission, 2010b; Institute of Chartered Secretaries and Administrators [ICSA], 2011; PwC, 2011b; IAASB, 2012). Formal research examining the role of the RI provisions in South African audits is, however, lacking. What is needed is rigorous, conceptual examination of the whistle-blowing duty to shed light on the practical operation of this corporate governance mechanism (see Kaplan and Ruland, 1991; Laughlin, 2007; Brennan and Solomon, 2008).

This thesis commences with this by asking if s45 of the APA has a perceived impact on the quality control systems of audit firms. As discussed in Section 2.2, what a number of recent corporate failures, several of which may have implicated the auditor, have done is shake the confidence vested in the profession's self-regulatory efforts. Through the lens of agency theory, arms-length regulation becomes a means of introducing additional controls, balancing a conflict between owing a duty to the public to issue reliable audit reports and the drive for higher profits, even if detrimental to audit quality. The RI provisions, by creating an additional reporting duty, may directly improve the quality of information made available to stakeholders. Concurrently, as compliance with the whistle-blowing provisions will be dependent on the extent to which the auditor has complied with ISA (see IRBA, 2006; Humphrey et al, 2011), this may provide an indirect incentive for improving the quality of local audit engagements.

## **2.2: AN AGENCY THEORY PERSPECTIVE ON AUDIT QUALITY**

---

### **2.2.1: AGENCY THEORY AND THE NEED FOR EXTERNAL AUDIT**

---

Central to the view that organisations constitute a nexus of contracts is the agency problem (Jensen and Meckling, 1976; Watts and Zimmerman, 1976). This describes how, in the presence of imperfect information, divergent interests between managers and shareholders leads to actions on the part of agents that may not be in the best interest of their principals (Berle and Means, 1932; Coase, 1937; Jensen and Meckling, 1976; Shleifer and Vishny, 1997; Solomon, 2010).

Under the lens of agency theory, both principals and agents are assumed rational utility maximisers, each seeking to improve their own position (see Hill and Jones, 1992; LaPorta et al, 1999; Fan et al, 2011). Consequently, shareholders - lacking the same degree of information possessed by managers - are not able to determine practically whether or not their appointed agents discharge all of their duties or whether these are executed to the best of their abilities (Arnold and de Lange, 2004; Solomon, 2010). 'Unless conflicting objectives can be brought into equilibrium' (Jensen and Meckling, 1976, p. 307), costs are ultimately incurred by the principal (Hill and Jones, 1992; Shleifer and Vishny, 1997; LaPorta et al, 1999; Arnold and de Lange, 2004; Bhagat and Bolton, 2008; Dickins, 2010; Bradley and Chen, 2011). To reduce these costs to acceptable levels, owners may introduce incentive schemes or contractual restrictions on agents to align agents' interests with their own (Hill and Jones, 1992; Shleifer and Vishny, 1997; Arnold and de Lange, 2004). Jensen and Meckling (1976), for example, theorise that opportunistic behaviour among different contracting parties could be restricted by tailoring the respective contractual provisions and defining the scope and nature of agents' duties (see also Shleifer and Vishny, 1997).

This is no easy task with effective contract enforcement requiring diligent monitoring that Jensen and Meckling (1976) argue is the purpose of external audit. For auditing, however, to be effective in reducing opportunism, the auditor should be able both to detect breaches of contract and have a propensity for reporting these to the principals (DeAngelo, 1981b; Watts and Zimmerman, 1983). In other words, for contractual arrangements to serve as a means of mitigating agency costs, effective monitoring of the arrangements in the form of high quality external audit is paramount (also consider Ashbaugh and Warfield, 2003; Solomon, 2009; Chen et al, 2011; Khan et al, 2011). If, alternatively, managerial incentives are used to align the interests of agents and principals (Jensen and Meckling, 1976; Drury, 2005; Botten,

2009), a similar relationship between agency costs and high quality external audit is evident. Incentives again necessitate the use of contractual arrangements and are subject to manipulation or misapplication, whether due to rogue agents or misinformed principals (Francis and Wilson, 1988; Krishnan, 2003; IAASB, 2009).

From the agent's perspective, a similar outcome results. Contractual arrangements and incentive schemes are often costly and will be unable to eliminate total shareholder losses yielding a residual loss (Cohen et al, 2002; Ashbaugh and Warfield, 2003; Epps and Guthrie, 2010). Total residual losses would, however, have a maximum as, beyond some point, the owner would lower managerial compensation, sell the firm to one who is better able to monitor it or simply replace rogue managers (Jensen and Meckling, 1976). As a result, agents may also bear costs associated with the agency problem. Conformance or *ex-ante* bonding costs, for instance, are incurred when managers attempt to make credible commitments as a 'bonding mechanism' that allays the concerns of the principal (Jensen and Meckling, 1976; Hill and Jones, 1992; Arnold and de Lange, 2004). One example of this would be the appointment of a high quality external auditor which signals to owners that agency problems are immaterial (Francis and Wilson, 1988; Krishnan, 2003; Fernando et al, 2010).

In this light, much of the prior corporate governance literature points to a positive relationship between agency costs and the demand for high quality audit services (DeAngelo, 1981a; Kaplan and Ruland, 1991; Power, 1991; Ashbaugh and Warfield, 2003; Power, 2003; Epps and Guthrie, 2010; Lin and Hwang, 2010; Chen et al, 2011; Khan et al, 2011; Zerni, 2012). Watts and Zimmerman (1983), for example, provide a historic account of the prevalence of incentive and contract-related agency problems in early English merchant guilds and regulated companies and of the possible beginnings of audit functions that were designed to address this. Audits were expected to be more than superficial, involving a detailed examination of expenses and monitoring for breaches of contract (Watts and Zimmerman, 1983; Sikka et al, 1998). Although not yet institutionalised, the early auditor was expected to be independent and to discharge his duties with due care. He could also be held accountable for a failure to do so (Watts and Zimmerman, 1983; Nel, 2001). Similar developments occurred in Renaissance Europe where the need for a system of monitoring state officials arose as commercial activity increased and separation of the owner-manager function resulted (Nel, 2001). The Industrial Revolution, emergence of joint stock companies, creation of limited liability concerns, and associated demands for refined financial reporting accentuated agency problems reinforcing the argument in favour of an independent audit function (Watts and Zimmerman, 1983; Miller and O'Leary, 1987; Chandler et al, 1993; Walsh and Stewart, 1993; Edwards, 2001; Nel, 2001). With the

increase in the number of companies, the extent and complexity of their operation, and dispersion of ownership, an auditing profession as a technical and independent monitoring functioning emerges (see Watts and Zimmerman, 1983; Hopwood, 1987; Zeff, 2003a).

Considering developments within the audit profession, the relevance of agency theory may continue to hold. Economic pressures within organisations coupled with new commercial challenges can be seen as necessitating the evolution of accounting and auditing practice during the 19<sup>th</sup> and 20<sup>th</sup> century (Burchell et al, 1980; Hill and Jones, 1992; Chandler et al, 1993; Nel, 2001; Baker and Owsen, 2002). Analogously, under the lens of stakeholder theory, more complex business relationships and organisations force corporate governance systems – including auditing systems - to deal with added complexity (consider: Hill and Jones, 1992; Fligstein and Feeland, 1995; Al-Twaijry et al, 2003; Zeff, 2003a; Lin and Liu, 2010; Solomon, 2010). As summarised by Watts and Zimmerman (1983, p. 626), the longevity of audit, in one form or another, and its continued prevalence, ultimately confirms that the attest function is an ‘efficient method of monitoring contracts between managers and those supplying capital’ and an integral part of the agency theory paradigm (see also Power, 1994; Baker and Owsen, 2002)<sup>25</sup>.

---

### 2.2.2: AUDIT QUALITY

---

While the prior corporate governance literature highlights a relationship between increasing agency costs and audit quality, it stops short of describing ‘audit quality’ or the factors that positively impact on it. With audit being an integral part of the system of checks and balances over organisations and the sound functioning of the capital market (Francis and Wilson, 1988; Griffin et al, 2010; Solomon, 2010), the need to understand the drivers of audit quality is clear. Audit quality is, however, impossible to observe directly (Power, 2003; Humphrey, 2008; Lawrence et al, 2011) with the result that several papers have turned to studying audit quality by measuring quality ‘surrogates’ (Francis, 2004).

DeAngelo (1981b) provides one of the first efforts in this regard. She argues that audit quality is positively correlated with the size of the audit firm. *Ceteris paribus*, the audit profession is characterised by barriers to entry allowing incumbent firms to earn ‘client

---

<sup>25</sup> In exploring changing audit practices, however, Humphrey (1990; 2008), Power (1994; 2003) and Pentland (1993; 2000) point to more than just a drive for economic efficiency or quality. Powerful social or institutional forces also seem to be at work, a line of thought explored in more detail in Section 2.3 and Section 2.4.

specific quasi-rents (1981b, p. 184) that act as an incentive for rendering high quality audit services (see also Watts and Zimmerman, 1983; Lim and Tan, 2008). The result is that the size and reputation of the audit firm becomes a form of collateral (see also Francis and Wilson, 1988; Lim and Tan, 2008), effectively guaranteeing a minimum level of audit quality that is higher for larger audit firms. Peel and Makepeace (2012), for example, find that the Big 4 charge a premium over their mid-tier four largest counterparts who, in turn, also enjoy a fee premium compared to smaller firms. The researchers conclude that this supports the hypothesis that the size and brand of the firm is associated with, at very least, a perception of higher quality services (see also Lim and Tan, 2008). The fact that larger firms, presumably characterised by greater information asymmetry between managers and principals and higher agency costs (Jensen and Meckling, 1976), tend to appoint one of the Big 4 as their auditors, lends weight to this argument (Francis and Wilson, 1988; Francis, 2004; Griffin et al, 2010; Clinch et al, 2012).

In addition, organisations audited by one of the larger audit firms tend to have lower levels of discretionary accruals (Francis and Krishnan, 1999), accruals that better track future profitability (Krishnan, 2003; Francis, 2004) and lower costs of capital (Fernando et al, 2010) and debt (Causholli and Knechel, 2012), than firms audited by smaller audit practices, although not all studies have consistently reached the same conclusion (see, for example, Lawrence et al, 2011). Focusing on the audit firms themselves, Church and Shefchik (2011) note that the Big 4, over the period 2004 to 2009, have fewer audit quality deficiencies than second tier practices. Palmrose's (1988) findings: that the Big 4 audit firms tend to enjoy a lower rate of litigation per client than their smaller counterparts, provides additional evidence in support of DeAngelo's (1981b) findings on the positive relationship between the size of audit firms and engagement quality.

Audit reports may also be telling 'quality indicators'. Francis and Krishnan (1999) and Boone et al (2010), for example, find that Big 4 audit firms are more likely to issue a modified report which the researchers interpret as signalling independence, conservative application of accounting and auditing principles, resistance to client pressures and an indirect measure of audit quality (see also DeFond et al, 2002)<sup>26</sup>. Similarly, Geiger and Rama (2006), using regression modelling, document that the Big 4 are less likely to modify erroneously the audit report or refrain from issuing such a report on the basis of doubt over the going concern

---

<sup>26</sup> Kaplan and Williams (2012) show that, over time, smaller audit firms may be more likely to modify their audit report due to concerns about the going concern assumption than the 'Big N'. This may, however, be attributable to changes in the audit market, such as the collapse of Arthur Anderson and enactment of SOX which has seen the larger audit firms dispense with riskier clients. The Big N are also more likely to have developed sophisticated client acceptance and continuance protocols which further limit the need to modify audit reports due to going concern risk.

assumption (see IAASB, 2009q) than smaller audit firms. While prior findings should not be construed as implying that the Big 4 firms *a/ways* outperform smaller practices in terms of engagement quality (for examples see Boone et al, 2010; Cullinan et al, 2012), the past research suggests that, at least on average, this may be the case (see Dechow et al, 1996; Francis, 2004; Boone et al, 2010).

Moving away from a direct quality/size distinction, differences in terms of industry specialisation may be an additional predictor of variations in audit quality (Lim and Tan, 2008; Clinch et al, 2012). Audit firms with greater industry-specific knowledge and experience may apply professional judgement and standards more appropriately, possibly due to an enhanced sense of brand awareness, risk of litigation and greater availability of resources (Velury, 2003; Francis, 2004; Jenkins et al, 2006). Habib (2011), for instance, posits that development of industry specialisation is a costly exercise which can be justified only by rendering higher quality engagements which attract additional clients, allowing recovery of initial costs. This is affirmed by Fernando et al (2010) who find a negative relationship between levels of audit-industry specialisation and client cost of capital.

Specialisation may also be a relevant quality surrogate at the audit-office level, especially since audit engagements tend to be coordinated and controlled from specific audit offices (Ferguson et al, 2003). Francis (2004), in a summary of audit quality research to date, for example, highlights how expertise within an audit-office (rather than for the entire firm) may be relevant for predicting high quality audit services. Similarly, Nagy (2012), concludes that the specialisation and experience of individual audit partners (see also Bedard, 2012; Zerni, 2012) may be a relevant quality-predictor because it is the individual partner who is ultimately responsible for the audit engagement (see also IAASB, 2009e; IAASB, 2009x). Research from the USA and Australia complements this, suggesting that the quality benefits of specialisation may be more pronounced when the audit firm in question is both the national and city-specific industry leader (Ferguson et al, 2003; Francis et al, 2005). Inherent complexity of the audit process, however, means that the prior research does not reach a definitive conclusion on the exact extent to which degrees of specialisation positively impact on audit quality (Velury, 2003; Francis, 2004).

In this light, other approaches to examining audit quality have focused on the issue of auditor independence. Fernando et al (2010), for instance, find evidence of audit tenure being positively correlated with a client's cost of capital, implying that long-standing relations with clients can lead to diminution of auditor independence and a perceived reduction in the credibility of the audit report (see also IFAC, 2006; Dart, 2011; Firth et al, 2012). The longer the audit tenure, the greater the stream of client-specific 'rents', the greater the loss from



termination of the client relationship and the lower the probability of the auditor reporting any detected breach (DeAngelo, 1981a; IFAC, 2006). For similar reasons, growing familiarity with a client's management (IFAC, 2006) may impair auditor independence, impact on the application of professional judgement and, hence, lower audit quality, especially for smaller audit practices (Li, 2010; Hardies et al, 2011). Combined with time pressures and profit-orientated business practices, the threat to auditor independence and audit quality may be significant (IFAC, 2006; Sikka et al, 2009; Lee, 2012) leading to calls for additional regulations to safeguard auditor independence, most notably restrictions on the rendering non-audit services and the need for either audit partner or audit firm rotation (Gavious, 2007; Riotto, 2008; European Commission, 2010b; Bazerman and Moore, 2011).

When it comes to the issue of rotating audit firms, the prior research does not reach a consensus. Elitzur and Falk (1996), for example, argue that auditor rotation may have the opposite effect on audit quality by restricting auditors' ability to develop industry or client-specific expertise. Likewise, Myers et al (2003, p. 796) conclude that 'increased audit tenure does not lead to reduced audit and earnings quality' although caution that this should not be construed as suggesting that refraining from embarking on audit firm rotation would lead to improved audit quality (see also Francis, 2004; Dart, 2011).

Similarly, there is uncertainty as to the precise relevance of rendering non-audit services (Lim and Tan, 2008; Liao et al, 2013). These have been the focus of considerable debate in both the academic and professional literature, especially following the Securities Exchange Commission's (SEC) prohibitions on audit firms rendering these types of services to their assurance clients (see Francis, 2004; Gavious, 2007; Sikka et al, 2009; European Commission, 2010a; Chahine and Filatotchev, 2011; Dart, 2011; Ianniello, 2012). Dopuch et al (2003), for example, in an experimental setting, provide evidence that where practitioners concurrently render audit and non-audit services, the result is a decline in auditor independence and, hence, audit quality (see also Gwilliam et al, 2000; IRBA, 2011). This may be especially true in low litigation risk environments where the potential for legal action against auditors does not provide an adequate safeguard against economic dependence on a client (Liao et al, 2013). Ashbaugh et al (2003), Asare et al (2005), and De Fond et al (2002), however, conclude that non-audit services may not automatically point to lower quality audits. In some cases, the rendering of these services may improve audit quality by providing the auditor with a greater understanding of the client or by leading to efficiency gains (Ezzamel et al, 2002; IFAC, 2006), especially if the auditor is also an industry specialist (Lim and Tan, 2008). From a more critical perspective, Schmidt (2012) suggests that non audit services may simply create the impression of a decline in independence which is exploited in the context of a highly litigious audit environment in the USA. This, ultimately,

leaves one with the conclusion that there is only '*some possibility that high levels of non-audit services may impair audit quality*' (Francis, 2004, p. 357, emphasis added).

A related stream of research considers the relevance of corporate governance structures and exogenous regulatory developments. For instance, Dechow et al (1996) and Liao et al (2013) point to an increased likelihood of auditors detecting misstatements when the respective client's board of directors is more independent. Complementing this is the sound functioning of audit committees which have a key role to play in moderating the relationship between auditors and management with an aim to improving the audit reporting process and lowering threats to auditor independence (see Gavigus, 2007; IOD, 2009; Solomon, 2010; Dao et al, 2012). More directly, high quality audit committees may add materially to the audit planning and testing process, as well as the scope of the attest function, leading to efficiency and quality gains (Chan et al, 2012). In some jurisdictions this is enhanced by a legal duty of audit committees to appoint and remunerate auditors (Rockness and Rockness, 2005; Riotto, 2008; IOD, 2009; Solomon, 2009). Shareholder activism may complement this. For example Dao et al (2012), find that when shareholders vote on the appointment or retention of the auditor, although audit fees are not reduced, audit quality, measured by reference to abnormal accrual levels and the number of prior period restatements, are reduced (see also Mayhew and Pike, 2004; FRC, 2007).

Going hand-in-hand with improvements in the corporate governance arena, and of particular interest for the purpose of this thesis, is the issue of increased arms-length regulation for audit firms, especially after a number of corporate scandals have shaken confidence in the functioning of external audit. Allegations of a lack of independence, inappropriate oversight by accounting bodies and underlying capitalistic pressures ushered in a calls for more external regulation of the accounting and auditing community (for examples, see Canada et al, 2008; Sy and Tinker, 2008; Bazerman and Moore, 2011). Most notable has been the enactment of SOX which, consequently, has received considerable attention from accounting academics.

One of the more recent SOX studies, carried out by Chambers and Payne (2011), finds that accrual persistence (which serves as their audit quality proxy) improves after the introduction of the legislation. Analogously, Carcello et al (2011), detect a significant improvement in accrual quality as a result of inspections by the PCAOB in post-SOX America, concluding that, the enactment of SOX has had a positive effect on audit quality. More specifically, Church and Shefchik (2011) find that the introduction of independent quality reviews by the PCAOB has led to a marked decrease in the number of control deficiencies by audit firms from the period 2004 to 2009. From a slightly different perspective, DeFond and Lennox

(2011) find that SOX has encouraged lower-quality auditors to exit the market, thereby improving audit quality on average<sup>27</sup>.

Although SOX may be an example of arms-length regulation having unintended consequences (Vakkur et al, 2010; Bronson et al, 2011), the initial argument is that external regulation has an important role to play in regulating minimum levels of audit quality (see Byington and Sutton, 1991; Manuel, 2002; Bazerman and Moore, 2011). Bazerman and Moore (2011), for example, argue that the traditional self-regulatory model has been unable to safeguard adequate levels of auditor independence, pointing to the possible use of additional regulation in response (see also Gavius, 2007; Sy and Tinker, 2008). Similarly, Canada et al (2008) demonstrate how a combination of public scrutiny, financial scandals, and growing discontent with auditors' self-regulation franchise provides the genesis of SOX which the authors describe as 'one of the greatest protections in history for the public interest within the arena of the financial markets and related corporate behaviour' (2008, p. 987). Finally, with repeated corporate scandals and criticism of the audit profession mounting, external regulation provides an important source of reassurance to users of audit reports. Additional laws and regulations allow governments to demonstrate that they are responding to a perceived decline in audit quality and that users can continue to place reliance on audit reports (Manuel, 2002; McMillan, 2004; Unerman and O'Dwyer, 2004)<sup>28</sup>

---

### 2.2.3: EXTERNAL REGULATION THROUGH THE LENS OF AGENCY THEORY

---

As discussed above, agency theory predicts the use of checks and balances to control agency costs (Jensen and Meckling, 1976; Grossman and Hart, 1983; Shleifer and Vishny, 1997; Solomon, 2010; Houghton et al, 2011). A capitalistic approach suggests that, if agency relationships can be adequately managed internally and by market forces, further external intervention is not required. With most agency costs already under control, the marginal costs of additional external regulation would exceed the marginal benefits (Jensen and Meckling, 1976; Kaplan and Ruland, 1991; Hill and Jones, 1992; Gwilliam et al, 2000; Tian and Twite, 2011).

---

<sup>27</sup> There is, however, no definitive conclusion on the effect of SOX and, in particular, PCAOB inspections on audit quality. For example Bishop et al (2012) find that while larger firms are less likely to have an audit quality deficiency noted by the PCAOB, the rate of defects does not decrease significantly between first and second time inspections.

<sup>28</sup> Unerman and O'Dwyer (2004) and McMillan (2004) also suggest that the reassuring effect of external regulation may be superficial, a line of thought explored in more detail in Section 2.3, Chapter 6 and Chapter 7.

From this perspective the state of self-regulation that has traditionally characterised the audit profession (Zeff, 2003a; Odendaal and De Jager, 2008) can be interpreted as a signal that external audit was seen as initially functioning adequately as part of the agency cost control machinery and that intervention by lawmakers was not required (Edwards, 2001; Konar et al, 2003). The converse may also be true. The emergence of additional auditor regulation can be seen as an indication that consumers of audit services no longer perceive audit as adequately mitigating the negative effects of diverging interests between principals and agents (Byington and Sutton, 1991; Peecher et al, 2007; Haigh and de Graaf, 2009). The promulgation of the SOX serves as a prime example (consider: Konar et al, 2003; Canada et al, 2008; Stein, 2008; Victoravich, 2010). In other words, an increase in residual losses is interpreted, in part, as being caused by a decline in audit quality, and hence effectiveness of the audit process (Gwilliam et al, 2000; Nel, 2001; Negash, 2004). As residual losses grow, additional external regulation makes sense as the marginal costs of added regulation are less than the marginal benefits of improved audit quality.

Nel (2001), Byington and Sutton (1991) and Shaked and Sutton (1981) explain that self-regulation's role is vested in the fact that the audit quality cannot be directly observed. This makes it difficult for external regulation to mandate changes that would bring about desirable reform within the confines of a marginal cost and benefit analysis. A closer examination of the audit industry, however, points to the existence of a monopoly or oligopoly. The industry enjoys substantial barriers to entry (Byington and Sutton, 1991); it is dominated by four large audit firms (FRC, 2008b; European Commission, 2010b; FRC, 2011); buyers are often forced by law to use the audit services (see, for example, Simunic, 1980; Watts and Zimmerman, 1983; Zeff, 2003b; Solomon, 2010); and cannot directly observe the quality of audit having to infer it from brand reputation or experience, making product differentiation difficult (DeAngelo, 1981a; Shaked and Sutton, 1981; Power, 1994). If the profession behaves like a monopoly, then it has little incentive to raise the quality benchmark above the absolute minimum. Audit firms must trade off higher levels of quality against lower levels of profit, something very difficult given capitalistic pressures at work in the audit industry (Sikka, 2004; Low et al, 2008; Baldvinsdottir et al, 2009)

If the buyer is dissatisfied, one of his only recourses is to raise the cost of poor audit quality, for example, by instituting legal action or changing audit firms. Audit firms have an incentive to improve audit quality to address directly these losses (Byington and Sutton, 1991; Gaa, 1991). Monopoly powers, and the desire for higher profits, however, mean that the audit profession is still only motivated to increase audit quality to the minimum required level (Shaked and Sutton, 1981; Byington and Sutton, 1991; Gaa, 1991; Pesqueux, 2005). As an

example, Humphrey and Moizer (1990), Byington and Sutton (1991) and Zeff (2003a) argue that the profession responds to widespread criticism with a flurry of new auditing and accounting standards. Similarly, in interpreting the change in the auditors' duty with respect to detecting and reporting fraud, Humphrey et al (1993b, p. 42) describe a complex political process seeking to 'manage the interplay between [the audit profession's] own interests and any competing public duties' (see also Humphrey and Moizer, 1990; Power, 1992). Ultimately, this may be designed to create the impression of improved quality while, in substance, leaving audit practice largely unchanged.

'Reforms' can, therefore, be seen as improving audit quality but only by the bare minimum. Similar arguments are raised by Pesqueux (2005), McMillan (2004) and Power (1994). Concurrently, setting additional standards allows the profession to control the definition of 'accepted' minimum requirements making it difficult for buyers to prove substandard work and hence materially raise quality levels (Byington and Sutton, 1991). The end result is a welfare loss which may justify the need for additional external regulation aimed at improving audit quality.

These perspectives suggest that the relationship between auditor and users of audit reports may echo the classical principal-agent problem in the sense that an expectation gap (see Dennis, 2010; Houghton et al, 2011) emerges between users, on the one hand, demanding reliable, high quality audits and auditors, on the other hand, potentially motivated to place profitability before audit quality (consider Gwilliam et al, 2000; Pesqueux, 2005). In this context, a highly litigious environments and lengthening chorus of criticism in the aftermath of Enron et al challenges the self-regulation *status quo*. More regulation is an indicator that the perceived costs of lower quality are sufficiently large to warrant a response from regulators (consider: Humphrey et al, 1993b; Peecher et al, 2007; Haigh and de Graaf, 2009; European Commission, 2010b; Bazerman and Moore, 2011). Concurrently, if the audit industry is characterised by monopolistic behaviour, then market forces alone will result in only a minimum level of quality standards leading to a welfare loss and again justifying the need for external regulation to enhance materially audit quality. In other words, external regulation becomes akin to systems of checks and balances - in a traditional corporate governance setting - dealing with divergent interests of agents and principals.

---

#### 2.2.4: A PRACTICAL PERSPECTIVE ON AUDIT QUALITY AND EXTERNAL REGULATION

---

In reaching this conclusion the exact means by which regulation impacts on audit practice has not been dealt with. The technicalities of audit remain a 'black box' (Power, 1994) that the prior research largely disregards in favour of inferential testing. Audit practice *itself* is not considered. Rather, how quality surrogates - most often discretionary accruals - change before and after the promulgation of external regulation, like SOX, are tested (Humphrey, 2008). 'Audit quality', therefore, remains narrowly defined. Seldom are multiple factors that could have a bearing on how audit firms execute engagements considered and rarely are the professional standards specifically dealt with. Related to this, few studies examine the *application* of those standards and regulatory requirements by audit practitioners inspired by an interpretive epistemology (Power, 2003; Humphrey, 2008). This leads Solomon and Trotman (2003, p. 409) to conclude that, the 'audit profession is rapidly advancing in response to change in its environment' but that 'auditing scholarship is advancing at a much slower pace'. These researchers, although favouring the use of experimental testing, point to an important role that context-specific research could play in shedding light on the intricacies of audit practice, audit quality and external regulation (Carcello, 2005; Humphrey, 2008; Humphrey, 2012).

For these reasons, rather than seeking to 'test' audit quality control systems, by using a single assumed quality surrogate, ISQC 1 is used to describe a quality-control-framework to analyse certain of the operational effects of the RI provisions on South African audit firms. Although, this may run the risk of professional bias (Power, 2003, p. 392), examining the perceived effect of s45 of the APA on ISQC 1 quality control 'elements' offers an opportunity to document precisely how an example of external regulation may impact certain aspects of audit practice and, indirectly, notions of audit quality.

In this respect, the Nel Commission (2001), and then Manuel (2002), suggested that the RI provisions would improve the confidence vested in South African external audit. The RI provisions marked a move towards more arms-length control over the profession after corporate scandals led to the profession's self-regulatory franchise being questioned. Section 45 of the APA would entrench a duty to report more than just in terms of the generic audit report adding value for stakeholders in the process (see also European Commission, 2010b; IAASB, 2012). Concurrently, and as discussed in Section 2.1, several measures were introduced to limit the application of professional judgement which could lead to inadequate reporting and broaden the original whistle-blowing duty enshrined in s20(5) of

the PAAA. Although the RI provisions do not create an active duty to detect RI's, including fraud, whether or not the auditor has discharged the reporting duty in good faith is inextricably linked to the extent to which he has complied with ISA (IRBA, 2006; IAASB, 2009h). Non-compliance with s45 of the APA is also an offence, giving rise to fines, imprisonment or both (IRBA, 2006; Maroun and Gowar, 2013). In addition, a failure to discharge faithfully the RI provisions may undermine the public standing of the respective firm and engagement leader (Chapter 6), result in professional sanctions, give rise to the risk of legal action and effectively brand the auditor as acting contrary to the public interest (Nel, 2001; Manuel, 2002; IRBA, 2006). As such, it may be reasonable to expect that the RI provisions provide an added incentive for an audit firm to ensure that engagements are executed to sufficient standards and that it has, by default, made reasonable efforts to discharge its duties under s45 of the APA. To date, however, there has been no direct research carried out on the implication of the RI provisions for audit practice and quality. Accordingly, the first research question is:

***A. Do the provisions of s45 of the APA have a perceived impact on the quality control systems of audit firms?***

This question is broken down into six sub-questions (A1-A6), each consistent with the provisions of ISQC 1 and the prior audit quality literature and which also serve as the basis for the correspondence analysis<sup>29</sup> (Chapter 5).

Firstly, and as discussed above, ethical fibre - most notably independence - is paramount (Bazerman and Moore, 2011). Carrington (2010) and Wines (2012), for example, argue that the auditor's professional standing, including both independence of fact and appearance (SAICA, 2012), are an integral part of high quality audits. The sentiment is shared by the IFAC Code (2006) and equivalent quality control standards in the USA (Bedard et al, 2008) which see independence of staff, and the culture of leadership driving firm-wide ethics, as crucial. A similar message is advanced in codes of corporate governance (IOD, 2009; Solomon, 2010).

When it comes to ISQC 1, the standard adopts a conceptual approach to audit firm governance (IAASB, 2009x). It requires audit firms to promote an 'internal culture' which champions engagement quality (IAASB, 2009x, p. 5) including the need to ensure the highest standards of ethical conduct. Threats to integrity, objectivity, professional competency and due care, professional behaviour and confidentiality must, therefore, be

---

<sup>29</sup> References to statements in the correspondence analysis are to row headings included in the correspondence table (Table 3.1) denoted 'R1' to 'R9'.

identified and mitigated appropriately (IFAC, 2006; IAASB, 2009x). In particular, the audit firm's leadership should pay attention to the ethical culture of the firm as a whole and the need for firm-wide policies that stress the importance of ethical behaviour (IAASB, 2009x, p. 14). Active and responsible leadership should be complemented by a performance measurement system which emphasises the relevance of audit quality and aligns it with the strategic objectives of the firm (Cohen et al, 2002; FRC, 2008a; Oosthuizen, 2011). These views provide the basis for the statements R1 and R2 in the correspondence analysis (Section 3.2.2) and inform the first two sub-questions:

1. ***Do the provisions of s45 of the APA cause engagement leaders to take a greater leadership responsibility role on external audits?***
2. ***What implications have s45 of the APA had on the perceived relevance and importance of adherence to ethical principles on external audits?***

Secondly, professional standing and reputation as a high quality auditor are also about association (Carrington, 2010; Bazerman and Moore, 2011; Wines, 2012). For this reason, ISQC 1, like US Generally Accepted Auditing Standards (GAAS) (Bedard et al, 2008), requires the use of formal client acceptance and continuance policies. For example, it recommends that firms only undertake those engagements which they have the necessary resources and skills to execute, a requirement which ensures ethical business conduct and avoidance of engagements characterised by an unacceptably high level of risk (IAASB, 2009x). As such, client acceptance and continuance decisions become integral for engagement quality and sound professional conduct (see also Cohen et al, 2002; Asare et al, 2005; Farag and Elias, 2011). King-III confirms this thinking, encouraging the use of formal codes of conduct and effective leadership that cultivate a culture of ethical awareness (IOD, 2009). Although not directly addressing client acceptance and continuance by audit firms, King-III refers to sustainable business practices and effective risk management, which would include an assessment of an organisation's business relations (Solomon, 2010; IRC, 2011; King, 2012). The need for clients to be serviced ethically and in a sustainable fashion while effectively managing operating and reputational risks also echoes principles of good corporate governance (see also Cohen et al, 2002; Asare et al, 2005; IOD, 2009; Farag and Elias, 2011; IRC, 2011; SAICA, 2012). This thinking informs statements R2 and R7 in the correspondence analysis (Section 3.2.2) and the third sub-question:

3. ***Does s45 of the APA lead to a more robust client acceptance and continuance review process and how does this relate to the need for risk management by audit firms?***



Finally, professional appearance and independence alone are not adequate (Humphrey and Moizer, 1990; Humphrey et al, 1992; Carrington, 2010). Under ISQC 1, audits ought to be executed to the highest standards in accordance with ISA (R3 in the correspondence analysis) and relevant regulatory requirements (IAASB, 2009x; PwC, 2010). To achieve this, effective human resource practices are important. Engagement teams require appropriate skills, resources and ethical standing to discharge their professional duties (R3 in the correspondence analysis) (IFAC, 2006; IAASB, 2009x). Concurrently, effective monitoring, supervision and consultation for complex issues involving high levels of judgement become paramount (R4 in the correspondence analysis) (IAASB, 2009x), re-emphasising the need for effective engagement leadership (R1 in the correspondence analysis) (IAASB, 2009e). At the heart of this, ISQC 1, similar to the essence of codes of corporate governance, stresses the importance of continuous improvement, internal quality control and sound documentation standards (R5 in the correspondence analysis) as well as the need for staff to feel both personally responsible and accountable for inferior engagement quality (R9 in the correspondence analysis). In this way, and in line with the sentiments of King-III, a commitment to sound audit practice becomes inextricably part of the sustainability of the audit firm (R7 in the correspondence analysis) and a possible source of confidence in (R6 in the correspondence analysis) and perceived legitimacy or value (R6, R7 and R8 in the correspondence analysis) of external audit. In other words, compliance with ISA - backed by sound engagement quality control protocols – is paramount for ensuring that audit reports are reliable, contribute meaningfully to corporate transparency and accountability and secure confidence in both the audit profession and the capital market system (R6 in the correspondence analysis)<sup>30</sup>. Hence the last three sub-questions ask:

4. ***What are the implications of s45 of the APA on the perceived importance of human resource practices?***
5. ***To what extent has s45 of the APA impacted on the performance of external audits including supervision, consultation and review in connection with these audits?***
6. ***Has s45 of the APA led to a more comprehensive continuous improvement and monitoring process at the audit firm level?***

---

<sup>30</sup> The association between the RI provisions and claims to legitimacy or credibility is discussed in detail in Section 2.3, Section 2.4, Chapter 6 and Chapter 7.

---

### 2.2.5: AN INSTITUTIONAL PERSPECTIVE ON AUDIT QUALITY

---

That external regulation can be attributed to the need for improved audit practice and quality in the name of economic rationality and efficiency is not, however, universally accepted (Fogarty et al, 1991; Humphrey, 2008; Humphrey, 2012). In particular, the agency theory view of the world, although widely used as a theoretical base (Hill and Jones, 1992; Brennan and Solomon, 2008), is not without limitations. The model mandates that the population of managers is homogenous by virtue of the utility maximisation assumption (Kaplan and Ruland, 1991). The work of Jansen and Meckling (1976) has a strong positivist world-outlook that is characterised by reductionism and the ability to achieve equilibrium. In addition, agency theorists 'often see the world as surrounded by efficient markets (Hill and Jones, 1992, p. 134), simply ignoring human interactions beyond contractual arrangements between managers and agents and other stakeholders (Solomon, 2010). As a result, developments in accounting and auditing systems, due to changes within organisations and social developments beyond the boundaries of the firm are not elaborated on (Kaplan and Ruland, 1991; Hill and Jones, 1992; Brennan and Kelly, 2007; Solomon, 2010; Talaulicar, 2010). Ultimately, agency theory's economic focus makes it potentially restrictive (Baxter et al, 2008; Brennan and Solomon, 2008).

For example, if material agency costs do exist, then theoretically market forces alone would drive the demand for external audit and legislated audit services would be redundant. At the extreme, if markets were perfectly efficient, then external audit would be replaced by the all-knowing market (Shleifer and Vishny, 1997; Lin and Hwang, 2010; Tian and Twite, 2011). Yet increasingly, more jurisdictions mandate the use of external audit and attempt to regulate audit quality (Kaplan and Ruland, 1991; Nel, 2001; Ashbaugh and Warfield, 2003; Gavigous, 2007; Riotto, 2008; IOD, 2009). This implies that agency theory does not provide a comprehensive account of developments in auditor regulation in the *real world*. In order to better understand the role of external regulation, and the case for South Africa's RI provisions, s45 of the APA needs be considered from alternate theoretical perspectives (consider Llewelyn, 1996; Humphrey, 2008). Stein (2008), Power (2003), Kaplan and Ruland (1991), Burchell et al (1980) and Hopwood (1987), for instance, suggest that developments in accounting and auditing, while being explained in part by agency theory, require the concurrent use of institutional theories for a richer rendition (consider: Fogarty, 1992; Roberts, 2001; Bhagat and Bolton, 2008; Brennan and Solomon, 2008; Dillard and Roslender, 2011; Grant, 2011; Harris and Ogbonna, 2011). Under the lens of institutionalism, the emergence of and compliance with external regulation may not only be

due to the need for economic efficiency but also part of a complex social process allowing organisations and institutions to secure legitimacy (DiMaggio and Powell, 1983; Suchman, 1995; Al-Twaijry et al, 2003). When corporate scandals shake the confidence vested in external audit and its self-regulatory franchise (Unerman and O'Dwyer, 2004), arms-length regulation of the profession may be an important means of restoring a sense of credibility in the attest function. When it comes to the RI provisions, the requirement to report client transgressions to an independent regulator (IRBA, 2006), appeals to acting in the public interest (Nel, 2001; Manuel, 2002) and conceptions of whistle-blowing as socially desirable (Vinten, 2000; Hwang et al, 2008; PwC, 2011b), may be important sources of pragmatic, moral and cognitive legitimacy (Section 2.3; Chapter 6).

## **2.3: AUDIT QUALITY, EXTERNAL REGULATION AND LEGITIMACY THEORY**

---

### **2.3.1: LEGITIMACY THEORY**

---

'Legitimacy' may be defined as:

'A generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs and definitions' (Suchman, 1995, p. 574) .

Organisations seek legitimacy because, in evoking a sense of desirability, appropriateness and 'uprightness', legitimacy garners support from jurisdictions (Meyer and Rowan, 1977; Ashforth and Gibbs, 1990; Suchman, 1995). It leads to organisations being seen as more 'natural', 'meaningful' and 'trustworthy' with resulting 'continuity and credibility being mutually reinforcing' (Suchman, 1995, p.574-575). Gaining, maintaining and repairing claims to legitimacy is, however, no easy task due largely to the very ethereal and highly dynamic nature of legitimacy.

For example, Fogarty (1992) explains 'legitimacy' cannot be directly observed. It is a subjective concept being influenced by moral cultural and social variables including past experiences and how these are interpreted (Power, 1995; Suchman, 1995; Llewelyn, 1996; Unerman and O'Dwyer, 2004; Georgiou and Jack, 2011). At the broadest level, legitimacy may be thought of as either strategic or institutional in nature, adding to an innate sense of subjectivity and difficulties encountered when attempting to 'pinpoint' sources of legitimacy.

In the first instance, it is seen as a resource to be used by organisations to achieve goals. Alternately, 'legitimacy' may be interpreted as rooted in 'constitutive beliefs' leading to legitimacy and institutionalisation becoming synonymous<sup>31</sup> (Suchman, 1995). Ultimately, the prior research identifies three 'sub-sets' of legitimacy, each of which is inherently normative, socially constructed and transient in nature, albeit to varying degrees.

Pragmatic legitimacy is rooted in an organisation's policies having perceived value for its immediate constituents (exchange legitimacy) or due to the organisation being regarded as responsive to constituents' interests (influence legitimacy) (Meyer and Rowan, 1977; Ashforth and Gibbs, 1990; Fogarty, 1992; Fligstein and Feeland, 1995; Suchman, 1995; Georgiou and Jack, 2011). A variant of pragmatic legitimacy, dispositional legitimacy, argues that 'modern institutional orders' have personified organisations leading constituents to afford legitimacy to those organisations that are 'moral', 'trustworthy' or 'socially responsible' (Suchman, 1995; Solomon, 2010). Pragmatic legitimacy is, however, ultimately based largely on 'self-regarding utility calculations' (Suchman, 1995, p. 585) and can be won using tangible rewards.

Moral legitimacy results from an assessment of whether an activity is well placed within socially constructed value systems and, in its purest form, transcends self-interests. Organisations may be judged morally on what they have accomplished (consequential legitimacy); on assessment of the social acceptability of attaining outputs (procedural legitimacy); or on whether or not the organisation is located within a morally favoured sector (structural legitimacy) (Goldhamer and Shils, 1939; Meyer and Rowan, 1977; Abbott, 1981; Molm, 1986; Suchman, 1995). These structures become important for legitimisation particularly where processes and outputs cannot be directly observed and may lead to the organisational identity, as opposed to its actual competency, becoming a determinant of legitimacy (Suchman, 1995).

Finally, an organisation may be accepted as legitimate on the basis of generally accepted belief, (Meyer and Rowan, 1977; DiMaggio and Powell, 1983; Suchman, 1995; Powell, 2007). If an organisation's activities or purpose are understood within a broader cultural context, resulting comprehensibility can accord legitimacy, especially when organisational

---

<sup>31</sup> Legitimacy may be thought of as either a strategic or institutional construct. The former sees legitimacy as an organisational resource used to achieve specific goals. The latter sees legitimacy as synonymous with institutionalisation: aimed at making organisations seem 'natural and meaningful'. Being reliant on social belief-sets, tensions between agents and principals are less relevant for institutional views on legitimacy (DiMaggio and Powell, 1983; Suchman, 1995, p. 576). As audit firms face both operational challenges and institutional pressures (Unerman and O'Dwyer, 2004; Wyatt, 2004; IRBA, 2011), no explicit distinction is made in this thesis between the two legitimacy 'models' (per Suchman, 1995).

accounts 'mesh both with larger belief systems and with experienced reality of the audience's daily life' (Abbott, 1981; DiMaggio and Powell, 1983; Suchman, 1995, p. 582). From a different perspective, cultural 'givens' or 'truths' can lead to alternatives for an organisation or its practices being disregarded and the 'legitimated entity becomes unassailable' (Suchman, 1995, p. 583).

---

### **2.3.2: AN INSTITUTIONAL PERSPECTIVE ON AUDITING**

---

Traditionally, accounting was portrayed as a neutral means of collecting, processing and reporting information with the aim of facilitating sound economic decision-making (Hopwood, 1987; Carruthers, 1995; Barth, 2008; International Accounting Standards Board [IASB], 2010). Likewise, audit was seen as a technical-rational function (Jensen and Meckling, 1976). Under the lens of agency theory, Section 2.2 touched on how auditing serves as part of the systems of checks and balances designed to manage divergent interests of agents and principals (Hill and Jones, 1992; Baker and Owsen, 2002; Solomon, 2010). Section 2.2 also alluded to the continued relevance of agency theory for explaining developments in audit and accounting practice. Economic pressures, coupled with growing commercial and industrial activity, necessitated the evolution and refinement of audit and accounting services to maximise efficiency, enhance reporting effectiveness and provide a source of value for stakeholders (see Burchell et al, 1980; Miller and O'Leary, 1987; Chandler et al, 1993; Walsh and Stewart, 1993).

In exploring changing audit practices there may, however, be more at work than just economic forces (Humphrey and Moizer, 1990; Pentland, 1993; Armstrong, 1994; Power, 1994; Pentland, 2000; Power, 2003; Humphrey, 2008). Peecher et al (2007), Powell (2007; 2010), Quattrone (2004), Humphrey and Moizer (1990) and Hopwood (1987), for example, suggest that accounting systems, and how these change over time, are a product of pressures at work within organisations, including broader societal changes (see also Miller and O'Leary, 1987; Humphrey and Moizer, 1990). Agency problems at the organisational level (Jensen and Meckling, 1976) and increasing numbers of stakeholders (Solomon, 2010; IRC, 2011) are still important accounting change-determinants. Varying societal expectations, institutionalisation and the need for legitimacy are, however, also important (see also Burchell et al, 1980; Hopwood, 1987; Kaplan and Ruland, 1991; Power, 2003; Parker, 2007; Peecher et al, 2007; Bengtsson, 2011; Bronson et al, 2011; Georgiou and Jack, 2011). As explained by Power (2003, p. 379): 'accounting systems, in their broadest

sense, function often more to legitimate individual and organizational behaviour than to support efficient and rational decision making'. This sentiment echoes the theories of Meyer and Rowan (1977): that the emergence and development of organisations may be attributed, not only to economic rationality, but to a complex process whereby formal rational or institutional structures are used to accord a sense of legitimacy. Longevity of the organisation is no longer secured solely by virtue of changes that make it more profitable or efficient, but using formal structures, processes and symbolic displays to confer credibility and trust (DiMaggio and Powell, 1983; Carruthers, 1995; Suchman, 1995).

One such process or 'display' may be the use of external audit. Being an important part of the corporate governance landscape (Watts and Zimmerman, 1983; Baker and Owsen, 2002; Solomon, 2010; Dart, 2011), external audit is integral to the system of checks and balances that ultimately serves to reduce agency costs to acceptable levels (for examples see Ashbaugh and Warfield, 2003; Lim and Tan, 2008; Fernando et al, 2010). By having a value-adding potential, the attest function effectively boils down to a possible source of pragmatic legitimacy. For example, the fact that organisations audited by a high quality external audit have lower costs of capital and fewer discretionary accruals (Section 2.2) implies that audit is able to offer actual benefits for stakeholders while simultaneously appearing responsive to the information needs of users of financial statements that would otherwise be constrained by the self-serving interests of distant managers (Jensen and Meckling, 1976; Watts and Zimmerman, 1983; Hill and Jones, 1992; Clinch et al, 2012). Exchange and influential legitimacy may, therefore, result.

Complementing this is audit's technical risk-based focus (IAASB, 2009c; IAASB, 2009k; IAASB, 2009m). Audit procedures are not simply informal or random but the product of well researched professional standards, scientific-type processes, and the application of prudential professional judgement by a highly trained independent practitioner (Humphrey and Moizer, 1990; Power, 2003; Sikka, 2009). Professional auditing standards take this one step further. They allow for, not only the expression of an opinion on a client's financial statements, but also a means for evaluating: the design and operating effectiveness of controls; key risk areas; and approaches for reducing these risks to acceptable levels (IAASB, 2009i; IAASB, 2009j; IAASB, 2009l; IAASB, 2009w; IAASB, 2011). While accentuating a perceived benefit for stakeholders, that this approach also attests to the very financial procedures and processes carried out at the audit client (MacLulich, 2003) may confer a sense of procedural legitimacy on the auditee. This benefit may be magnified by the expansion of audit services into the area of risk and integrated reporting, effectively influencing a large number of stakeholders to regard audit as an imperative for assessing an

organisation's structural and consequential legitimacy (Power, 1991; Power, 1994; O'Dwyer et al, 2011). As explained by Power (1994) the attest function is aligned with the ideals of quality, good governance and sense of accountability and, as such, an important source of moral and pragmatic legitimacy for the audited.

Integral to this may be the complex operational, financial and institutional environments in which modern organisations function (Giddens, 1990; Giddens, 1991; Unerman and O'Dwyer, 2004). Where users of financial reports are not able to comprehend fully these documents or directly observe the processes taking place within organisations, external audit plays a significant role in preserving the credibility of the capital market process (Unerman and O'Dwyer, 2004). The simple fact that a company's financial statements have been audited by an independent professional (IAASB, 2009x) with technical expertise (Humphrey and Moizer, 1990), therefore, becomes an important means of securing the legitimacy of the organisation's financial reporting and, hence, its credibility in the eyes of stakeholders (consider Power, 1994; IOD, 2009; O'Dwyer et al, 2011). It may very well be the case that acts of 'resistance [to external audit] look like attempts to preserve abuses of privilege and secrecy' (Power, 1994) to the point where audit has come to be seen as an indispensable part of daily corporate life (consider Power, 1999; Pentland, 2000; Solomon, 2010) and possible source of cognitive legitimacy for an organisation with a 'clean' audit report.

To, 'generate trust in financial statements', however, 'audit practice must generate trust in itself' (Power, 2003, p. 380). In other words, a paradox emerges in terms of which audit, as a socially constructed practice, is both able to confer legitimacy on organisations while, at the same time, dependent on its own perceived legitimacy in order to do so (see also Power, 1997; Unerman and O'Dwyer, 2004; O'Dwyer et al, 2011). For this reason the growing importance of accounting systems; increased information demands of varied stakeholder groups; emergence of laws mandating external audit; and the growing complexity of accounting and auditing standards has been identified with the institutionalisation and professionalisation of accounting and auditing. The primary aim: securing claims to legitimacy (Burchell et al, 1980; Zucker, 1986; Power, 1994; Fligstein and Feeland, 1995; Baker and Owsen, 2002).

In this light, the accounting and auditing fraternity has actively recruited mainly cosmopolitan workers, simultaneously dictating minimum levels of entry requirements to the profession and levels of technical knowledge (Burchell et al, 1980; Chandler et al, 1993; Edwards, 2001). Going hand in hand with this has been the development of a formal autonomous role

for accounting and auditing backed by professional bodies which represent member interests (Burchell et al, 1980; Hopwood, 1987; Cooper and Robson, 2006); the standardisation of accounting and auditing practice (Power, 1995; Power, 2003; IAASB, 2009l); and the codification of informal procedures (Hopwood, 1987; Power, 1995; IAASB, 2009x), each of which adds to the image of the profession as a repository of revered technical expertise (Humphrey and Moizer, 1990; Power, 1994) and, thus, of a legitimate player.

MacLulich (2003), for example, explains how a move to risk-based auditing may be attributed not only to the need for more efficient audit practice, but to the desire to perpetuate belief in the 'rituals' of auditing. The existence of formal auditing and accounting standards rooted in conceptual frameworks and professional judgement become synonymous with the view of auditors as expert decision-makers working tirelessly to reach an informed conclusion on the fair presentation of financial statements (Humphrey and Moizer, 1990; MacLulich, 2003; Wyatt, 2004). The result is an appeal to exchange and influential legitimacy (Suchman, 1995).

Power (1994; 1995) also sees audit as socially and contextually driven. He argues that auditing standards, decision aids and working papers are not only about ensuring high levels of audit quality. They play an important role in 'confer[ing] credibility by linking particular audits to generally accepted knowledge' (Power, 1995, p. 324). Audit sampling (IAASB, 2009o; IAASB, 2009p), for instance, facilitates a delicate balance between the application of professional, but still normative, judgement and the use of visible techniques for the execution of audit tests that can be used to enhance the credibility of the audit process (Power, 1992; Power, 1995; Power, 2003). Likewise, a reliance on structured approaches to audit (see IAASB, 2009l; IAASB, 2009k; IAASB, 2009m) 'reflects the increasing demand for legitimate and transparent forms of standardised practice' (Power, 2003, p. 381).

Continuing under a lens of legitimacy theory, Humphrey and Moizer (1990) provide an account of the audit planning process. They explain that, in addition to improving audit quality, audit planning is an important 'marketing' tool. The planning process not only ensures efficient and effective practice (IAASB, 2009k; IAASB, 2009m) but allows for the legitimisation of the nature, timing and extent of audit work and of the fee charged. As a result, technical professional standards and 'scientific' approaches (Power, 1992; Power, 2003) to audit practice become an important form of impression management that secures the continued standing of the attest function and its perceived moral and pragmatic legitimacy (Power, 1995; Pentland, 2000; MacLulich, 2003; Power, 2003).



This is reinforced by claims to serving the public interest. With users of financial statements unable to appreciate every aspect of the financial reporting system, external audit serves to express an opinion on financial statements and, therefore, becomes a means of ensuring trust in investment markets (Unerman and O'Dwyer, 2004). Underlying this is a taken-for-granted confidence in external audit as central to protecting the interests of stakeholders (Power, 1994; Pentland, 2000; Unerman and O'Dwyer, 2004) emanating from images of professionalism, technical training and expertise, prudential professional judgement and the independent practitioner (consider Watts and Zimmerman, 1983; Humphrey and Moizer, 1990; Power, 1994; Mosso, 2003; Francis, 2004; IAASB, 2009c). At the extreme, these professionals came to be seen as a class of 'gentlemen', highly skilled and beyond reproach (Chandler et al, 1993; Edwards, 2001), possibly signalling the achievement of cognitive legitimacy (consider: Humphrey and Moizer, 1990; Power, 1994; Sikka et al, 1998). The result is that a modern capital market without an independent external audit function has become almost unimaginable (see Power, 1994; Power, 2003; IOD, 2009; Solomon, 2010).

Legitimacy is not, however, static (Suchman, 1995; Power, 2003; Rodrigues and Craig, 2007; Georgiou and Jack, 2011; Smith-Lacroix et al, 2012). If the accounting profession is built on the trust vested in it by society (Power, 2003; Unerman and O'Dwyer, 2004; O'Dwyer et al, 2011; SAICA, 2012) it needs to preserve its claim to legitimacy to ensure continued existence. In other words, just as economic pressure may stimulate organisational change, together with emerging social or contextual issues, challenges to institutional legitimacy may also result (Suchman, 1995). For the audit profession in particular, this may be especially true when corporate failures shake the confidence vested in the attest function (Kaplan and Ruland, 1991; Unerman and O'Dwyer, 2004; Sikka, 2009; O'Dwyer et al, 2011; Smith-Lacroix et al, 2012).

---

### **2.3.3: EXTERNAL REGULATION OF THE AUDIT PROFESSION AS A SOURCE OF LEGITIMACY**

---

---

#### **EXTERNAL REGULATION AND AUDITOR LEGITIMACY**

---

Auditors' roles and responsibilities are a hotly debated topic, particularly in the aftermath of corporate failures (Tremblay and Gendron, 2011; Gold et al, 2012). Scandals inevitably lead to a diminution of trust in the audit profession and are often followed by an increase in defined responsibilities or a reduction in autonomy (Byington and Sutton, 1991; Gaa, 1991; Humphrey et al, 1992; Laughlin, 2007; Marnet, 2007; European Commission, 2010a;

Tillema and ter Bogt, 2010). In each instance, the aim is purportedly an improvement in the functionality and quality of the audit process (Hopwood, 1987; Miller and O'Leary, 1987; Canada et al, 2008). As explained by Hopwood (1987, p. 211) 'much accounting change has resulted from such conceptions of an accounting potential'. Enhancing this potential provides a means of addressing the ever more demanding needs and interests of separated managers and owners, and a growing body of other stakeholders, thereby securing legitimacy (Burchell et al, 1980; Burchell et al, 1985; Hopwood, 1987; Suchman, 1995). In this respect, a self-regulatory approach has proved instrumental in reassuring constituents of the credibility of the external audit process (see Shaked and Sutton, 1981; Humphrey and Moizer, 1990; Edwards, 2001; Zeff, 2003a; Rockness and Rockness, 2005; Bayou et al, 2011). Peer reviews to ensure high quality audit engagements, often under an established accounting body (see Zeff, 2003a; Carcello et al, 2011; Malsch and Gendron, 2011); the development of codes of conduct (examples include IFAC, 2006; SAICA, 2012); controlling entry to the profession through formal examinations (Byington and Sutton, 1991; Chandler et al, 1993; Low et al, 2008) and continuous revision of technical standards (for examples see Barth, 2008; IASB, 2010; FRC, 2011; IAASB, 2012) are examples of the largely self-regulatory measures that have, historically, been integral to maintaining the legitimacy of the audit profession.

In each case, a self-regulation is used to bolster the trust vested in the profession and preserve its credibility (Mosso, 2003; Chang et al, 2009a; Chang et al, 2009b; Carrington, 2010; Chiaburu, 2010). As Power (1995), Humphrey and Moizer (1990) and Khalifa et al (2007) explain: auditing standards, technicalities, claims to independence and quality assurance processes become part of the 'rituals' of social legitimisation and hence a demonstrable commitment to the serving the interests of constituents. As discussed previously, auditors were historically seen as 'gentlemen' (Edwards, 2001) - a professional elite acting in the public interest and above ethical reproach. They were automatically trusted (Humphrey et al, 1992; Wyatt, 2004; Baldvinsdottir et al, 2009; Guénin-Paracini and Gendron, 2010). Concurrently, the very purpose of and need for audit becomes generally accepted as an integral part of the corporate governance landscape (see Power, 1994; Solomon, 2010; Humphrey, 2012) signalling the attainment of cognitive legitimacy for the profession and, by default, its self-regulatory franchise.

Under a banner of self-regulation, a legitimacy reserve (see also Ashforth and Gibbs, 1990; Suchman, 1995; Edwards, 2001) has resulted meaning that isolated issues have not led to a material threat to the profession's standing. Faced with a corporate failure, the profession has been able to create an effective 'firewall' between challenges to previously won

legitimacy and the on-going 'essence' of the institution (see Zucker, 1986; Suchman, 1995). For example, assumed deficiencies have been successfully ascribed to a misunderstanding of the scope of external audit by constituents and responded to with calls for educating users about the nature and purpose of the audit function (Fogarty et al, 1991; Sikka et al, 1998; Gold et al, 2012). In other instances, the profession has reviewed its independence protocols (European Commission, 2010b; Dart, 2011; Wines, 2012), bolstered quality review processes (Nel, 2001; FRC, 2008a; FRC, 2010; Carcello et al, 2011) and revised professional standards (see Byington and Sutton, 1991; IAASB, 2012) with an aim to demonstrating its commitment to high quality audit practice and, thus, preserving its legitimacy. Paradoxically, the result is that even when corporate failures strike, the response has been a call for ever more monitoring and review in the form of additional audit (Power, 1994; Guénin-Paracini and Gendron, 2010).

Repeated failures and corporate scandals can, however, begin to 'deplete' an institution's legitimacy reserve (Suchman, 1995). They signal to users that automatic or taken-for-granted belief in the sound functioning of the audit system may be unfounded and that external intervention could be necessary (Unerman and O'Dwyer, 2004; Boolaky, 2011; Wines, 2012). As summarised by Anderson and Ellyson (1986, p. 99):

'Many leaders of the profession strongly believe...that dealing with [audit quality].... perception problems ultimately boils down to this question: Will the profession adequately and credibly regulate itself-or will the public demand that the Government play the cop on the beat?'

Unerman and O'Dwyer (2004) point to the latter. Exploring the demise of Arthur Anderson, they argue that the collapse of Enron led to a widespread withdrawal of trust from the expert system, with the result that a corporate scandal - initially limited to only a single organisation and its auditor - soon had implications for the legitimacy of the audit profession (and its self-regulation franchise) on a global level. For these researchers, the audit opinion is an example of a 'token symbol' in the sense that it has little value in itself but is, nevertheless, able to convey the soundness of the financial statements and communicate the results of the audit process (an 'expert system')<sup>32</sup>. That users place reliance on the audit opinion, in spite of the fact that many have only limited knowledge of the expert system, implies that there is some measure of trust in the process and assumption that the 'token symbol' carries value. In other words, and as discussed previously, there is the generally accepted belief (cognitive legitimacy), rooted in past experiences and perceptions of users (a legitimacy reserve) that the audit opinion is appropriate and is backed by high quality audit evidence. When, however,

---

<sup>32</sup> Unerman and O'Dwyer's (2004) work is based on Giddens' (1991; 1990) theory of modernity.

'a particular abstract system fails to meet widely held expectations of non-expert outsiders, processes of reflexivity may lead to a widespread withdrawal of trust by these non-experts and development of cynicism towards this abstract system' (Unerman and O'Dwyer, 2004, p. 978) .

In other words, 'unconscious trust', an indicator of cognitive legitimacy, can be undermined by numerous and repeated scandals (Giddens, 1990; Mosso, 2003; Unerman and O'Dwyer, 2004, p. 979 & 984). In this setting, the profession's self-regulatory efforts can come to be perceived as simply minimising the perception of the weakness of the audit process (Kaplan and Ruland, 1991; Unerman and O'Dwyer, 2004) and increasingly ineffective at securing legitimacy (see Mosso, 2003; Zeff, 2003b; Bazerman and Moore, 2011). For example, Unerman and O 'Dwyer (2004) describe how non-expert users of audit reports develop a new-found appreciation for the fallibility of external audit and limitations of the profession's review and quality controls processes. Accordingly initial efforts in the USA to 'ring fence' the Enron debacle or to attribute it to isolated issues, readily resolved by existing self-regulatory measures, are unsuccessful (Unerman and O'Dwyer, 2004). A deepening crisis of legitimacy results, culminating in a review of the credibility of the assurance function in several jurisdictions and, most notably, the promulgation of arms-length regulation for the audit profession (Manuel, 2002; Unerman and O'Dwyer, 2004; Canada et al, 2008). Effectively, cynicism leads to acts of self-regulation being seen as mere symbols used to conjure up pragmatic or procedural legitimacy but lacking in substance (Edwards, 2001; Fuerman, 2004; Sikka, 2004; Pesqueux, 2005; Marnet, 2007).

More critical still, the profession may be seen as exerting economic and political power in pursuit of self-gain with little regard for its stated objective of serving the public interest (consider Power, 1994; Mitchell and Sikka, 2002; Zeff, 2003a; Pesqueux, 2005; Marnet, 2007; Low et al, 2008; Baldvinsdottir et al, 2009). For example, suspicion has been raised that the 'independence', 'integrity', 'professional competency' and 'due care' amount to a 'professional mystique' that is used to further the economic interests of members of the profession (Humphrey and Moizer, 1990; Humphrey et al, 1992; Pesqueux, 2005). As a result, the efforts of the profession *alone* to respond to various corporate failures, and more recently the global financial crises, are not enough (Unerman and O'Dwyer, 2004; Odendaal and De Jager, 2008; Riotto, 2008; Bayou et al, 2011; Carcello et al, 2011). Delegitimized structures are, therefore, 'quarantined' and monitors put in place by independent regulators to prevent subsequent failures (Suchman, 1995). The promulgation of SOX, with mandatory audit quality provisions (Riotto, 2008; Sy and Tinker, 2008; Bronson et al, 2011; Cullinan et al, 2012); formation of the PCAOB (Mosso, 2003; Kaplan and Williams, 2012), revocation of Arthur Andersen's licence (Unerman and O'Dwyer, 2004); and calls for separation of non-

assurance practice from existing audit firms (European Commission, 2010b; Bazerman and Moore, 2011; Wines, 2012) serve as examples.

Each case points to the introduction of an 'audit quality discourse'. Exogenous control of the profession is offered to constituents as a key means of improving existing audit practice following a number of widely publicised corporate failures. The focus on audit efficiency, drive for increased competitiveness and variation of service offering appears to be tempered by the need for quality control (IAASB, 2009x; IAASB, 2009e) - including formal documentation of how firms ensure the execution of engagements to high standards - and the application of sound professional judgement (PCAOB, 2006; PCAOB, 2007; Blankley et al, 2012). Khalifa et al (2007) describe this as highlighting a key relationship between discourse and practice that shows how audit firms have possibly embraced a more stakeholder-centric outlook in the wake of additional arms-length control over audit practices.

In this context, the USA, UK, France, Italy, Austria, Canada, Germany, Australia and New Zealand Governments and regulatory bodies are responding to a perceived crisis of legitimacy in the audit profession by moving away from a system of self-regulation to one where audit practice is increasingly subject to external control (Nel, 2001; Konar et al, 2003; Laughlin, 2007; Canada et al, 2008; European Commission, 2010b; Bronson et al, 2011; Kaplan and Williams, 2012). With self-regulation no longer seen as a viable source of legitimacy, external regulation may come to be interpreted as a *bona fide* effort to improve quality and restore confidence in the 'expert system' (Kaplan and Ruland, 1991; Unerman and O'Dwyer, 2004; Odendaal and De Jager, 2008; Riotto, 2008; Bayou et al, 2011; Carcello et al, 2011). As alluded to by Zucker (1986), Kaplan and Ruland (1991) and Suchman (1995), with the efficiency of one legitimising technique reduced, alternate means of enhancing audit legitimacy are needed.

South Africa's RI provisions may be one such example and this provides the basis for the second research question:

***B: Does, s45 of the APA afford perceived legitimacy to South African external audit?***

## **SOUTH AFRICA'S RI PROVISIONS AS A POSSIBLE SOURCE OF LEGITIMACY?**

---

Discussing the promulgation of s20(5) of the PAAA, the South African Minister of Finance noted:

'A most important aspect of this piece of legislation is Parliament's recognition of the principle that an auditor owes a duty not only to his client but also to the public. For many years auditors have been in doubt as to their responsibility to the public. Parliament has now given a clear and unequivocal answer' (Minister of Finance of the Republic of South Africa cited in Nel, 2001, p. 318).

The European Commission (2010b), Solomon (2009; 2010), CESR (2007) and IRC (2011) argue that improved reporting by external audit is paramount for enhancing investor confidence in the capital market and audit process itself. As explained by Power (1994; 2003), audit is effectively valueless unless meaningful results can be communicated to the relevant stakeholders (see also O'Dwyer et al, 2011). From this perspective, the RI provisions can be seen as taking cognisance of this, adding to the scope of the auditor's reporting duty in order to provide additional insights into organisations' activities (Nel, 2001; SAICA (2001), cited in Nel, 2001). Other jurisdictions rely on comparable reporting duties for a similar reason.

Denmark, France, Norway and Sweden, for example, require auditors to report certain irregularities to directors. France, Iran and Malaysia extend this duty by mandating that certain offences be reported to appropriate authorities (Nel, 2001). The UK, Ireland and Australia also have instances where reporting transgressions to third parties is required (Brennan and Kelly, 2007; Institute of Chartered Accountants of Scotland [ICAS], 2010; ICSA, 2010). As a general rule, EU Member States are obliged to report 'any fact or decision which is liable to constitute a material breach of laws, affect the ability of the company to continue as a going concern, or lead to a qualified audit report' to relevant authorities. The reporting duties apply mainly to the financial services sector (European Commission, 2010b). Finally, in the USA, SOX indirectly mandates a broad form of whistle-blowing in that s404 of SOX requires auditors to report formally on control deficiencies. (Riotto, 2008; Epps and Guthrie, 2010). Professional standards may give rise to additional reporting duties in limited cases (AICPA, 1972; Nel, 2001; AICPA, 2007; AICPA, 2009; IAASB, 2009h). Each instance speaks to the need for improved communication standards, enhanced transparency and defining auditors' reporting responsibilities (see also IAASB, 2012).

Conceivably, the growing societal demand for improved and clarified reporting by auditors may provide an impetus for mandated whistle-blowing duties (consider, for example,

Hopwood, 1987; Kaplan and Ruland, 1991; Power, 2003; Reckers-Sauciuc and Lowe, 2010). Based on the work of Suchman (1995), it may be argued that whistle-blowing is itself increasingly seen as a legitimate act by some constituencies (see, for example, Hwang et al, 2008; IOD, 2009; Seifert et al, 2010; KPMG, 2011). More specifically, the whistle-blowing literature suggests a source of pragmatic and moral legitimacy. For example, whistle-blowing is perceived by some stakeholders as an invaluable means of improving transparency and fortifying confidence in the respective organisation (Vinten, 2000; Vinten, 2003; ICAEW, 2004; Hwang et al, 2008; Reckers-Sauciuc and Lowe, 2010). According to Staub (1978), the act of reporting transgressions becomes 'pro-social' in the sense that it is based on a quest for maximisation of societal, as well as personal, utility and, thus, interconnected with a sense of moral duty (consider also Miceli and Near, 1984; Crotty, 2007; Hwang et al, 2008). Accordingly, far from being 'subversive and undesirable, [the act of reporting transgressions] may sometimes deserve high praise' (Vinten, 2000, p. 1). As explained by Reckers-Sauciuc and Low (2010), examining the crisis of confidence post Enron et al, there is a strong connection between ethics, moral commitment, openness and whistle-blowing with the result that:

'Some standard of ethics needs to be upheld; and businesses truly need to adopt policies, practices and procedures that advance integrity-in-action (not just talk) if we are ever going to recover our bearings. Provisions for whistle-blowing without retaliation would be one such practice' (2010, p. 259).

A similar sentiment is evident in the popular media where several examples may be found of the efforts of whistle blowers being championed as a moral ideal in the public interest (consider Vinten, 2003; Boswell and Anderson, 2011; Vecchiatto, 2011). For instance, Enron, WorldCom and Global Crossing have become akin to case studies for ethical breakdowns where the utility of whistle-blowing was demonstrated and actions of the respective whistle-blowers were celebrated by some stakeholders as promoting societal welfare (see, for example, Staub, 1978; Vinten, 2003; Nam and Lemak, 2007; Hwang et al, 2008). This view is iterated by, *inter alia*, PwC (2011a; 2011b) and the ICSA (2010; 2011) who argue that sound whistle-blowing mechanisms have an important function to play in ensuring a firm's commitment to ethical business conduct. King-III (IOD, 2009); allegations of price-fixing at Sasol and Tiger Brands (Crotty, 2007); and the introduction of a fraud hotline with direct links to the Presidency (Mboyisa, 2009) provide South African-specific examples of the perceived benefits inherent in whistle-blowing.

From this perspective, whistle-blowing is an integral part of the governance machinery entrenching ideals of transparency, accountability and stewardship (Vinten, 2000; ICAEW, 2004; IOD, 2009; Solomon, 2009; Solomon, 2010). As an example of auditors being expected to bring certain transgressions into the open, the RI provisions may be a means of achieving similar ends (consider: Nel, 2001; European Commission, 2010b; KPMG, 2010; Seifert et al, 2010). For this reason, active encouragement of improved reporting protocols in auditing circles is gaining acceptance (consider: Schultz et al, 1993; Read and Rama, 2003; IRBA, 2006; Nam and Lemak, 2007; Hwang et al, 2008; IRBA, 2010a). Contemporaneously, it may be part of a growing societal expectation for additional disclosure by auditors (ICAEW, 2004; CESR, 2007; Solomon, 2009; European Commission, 2010b; ICAEW, 2010; IAASB, 2012). By legislating reporting duties for auditors, law makers may be capitalising on perceptions of whistle-blowing, backed by the formality of an Act of Parliament, to add to the perceived legitimacy of the external audit process and the quality of information reported by auditors. In other words, with whistle-blowing seen as 'pro-social' (Staub, 1978; Solomon, 2010; PwC, 2011b), compliance with the RI provisions may be tantamount to conforming to societal expectations and providing perceived value for constituencies securing a sense of both pragmatic and moral legitimacy (consider: Fogarty, 1992; Suchman, 1995; Rodrigues and Craig, 2007).

At the extreme, the use of an apparently rational public interest reporting requirement may form part of the 'cognitive base' of the profession's activity. That the RI provisions are enshrined in statute; executed by independent and highly trained professionals; apparently rational; and purportedly in the public interest, may allow the act of whistle-blowing to afford a sense of cognitive legitimacy to the South African audit profession (consider DiMaggio and Powell, 1983; Suchman, 1995).

From a slightly different perspective, the same social context in which whistle-blowing is championed can have a coercive effect on organisations, leading to the emergence of formal policies and procedures which encourage the act of reporting transgressions in order to win public favour and, hence, secure legitimacy (consider Meyer and Rowan, 1977; Suchman, 1995; Al-Twajjry et al, 2003). DiMaggio and Powell (1983) provide an example of the subtle operation of 'coercive isomorphism' whereby smaller, urban organisations are indirectly compelled to introduce hierarchical structures to secure their legitimacy in the eyes of hierarchically organised corporates upon which they are dependent. By analogy, similar processes of coercive isomorphism may be at work when considering the RI provisions. The formal, technical, legal aspects of the RI provisions may leave the audit firm with a sense of being compelled to honour its legal responsibilities in order to demonstrate to constituents legitimate operating procedures (consider DiMaggio and Powell, 1983; Suchman, 1995).



This may be especially true given that the RI provisions appeal to notions of acting in the public interest (Nel, 2001), implying that the failure to comply with the whistle-blowing duty could be construed as *mala fides*. In other words, 'because these [provisions] are considered proper, adequate, rational and necessary, organizations must incorporate them to avoid illegitimacy' (Meyer and Rowan, 1977, p. 345).

Concurrently, and as discussed above, a host of corporate failures and the on-going financial crisis has shaken the confidence vested in the audit profession's self-regulatory framework (Unerman and O'Dwyer, 2004; Sy and Tinker, 2008; Bazerman and Moore, 2011). Being perceived as non-compliant with the RI provisions could be construed as failing to recognise constituents' concerns and, thus, pose a threat to the standing of the respective audit firm (consider Suchman, 1995). By the same token, with the international community appearing to favour the use of additional exogenous control over the profession (consider CESR, 2007; European Commission, 2010b; Arping and Sautner, 2012), for the South African regulator to shy away from a similar move may have smacked of ineffectiveness, a failure to meet international standards, and a limited recognition of the importance of sound external audit practice (Nel, 2001; Konar et al, 2003). The result is a refinement of the whistle-blowing duty, expansion of its scope and the use of material sanctions to deter non-compliance as a possible signal that the South African audit profession is also moving towards greater use of arms-length regulation (Section 2.1).

'Uncertainty is...a powerful force that encourages imitation' in the quest for legitimacy (DiMaggio and Powell, 1983, p. 151). An organisation, by modelling itself on those appearing most successful, prominent or revered may be able to rationalise its own operations or win comparable support from constituents, thereby bolstering notions of legitimacy (DiMaggio and Powell, 1983; Suchman, 1995; Al-Twaijry et al, 2003). As explained by Ashforth and Gibbs (1990, p. 178):

'To the extent that [generally accepted] paradigms exist for the relevant domain, structures, and processes, legitimacy may be gained by simply conforming to the paradigms ...[I]somorphism "signals" the fitness—the apparent willingness and ability of the organization to fulfil constituents' role expectations'.

In this context, if leading economies are heeding the call for additional arms-length regulation, then it may be possible for a developing country to bolster the perceived legitimacy of its own auditing profession by appearing to adopt comparable 'innovations'. The USA responds to criticism of auditors with SOX and the introduction of the PCAOB (Canada et al, 2008; Carcello et al, 2011). The European Community explores mandatory auditor independence provisions and additional reporting requirements

(European Commission, 2010b). Likewise, South Africa attempts to demonstrate its effort at reform with a revision to its company law (Konar et al, 2003; Companies Act, 2008), the drive for a more independent regulatory body for auditors (Konar et al, 2003) and the entrenchment of the RI provisions to broaden the auditor's reporting duty in the name of serving the public interest (Nel, 2001).

---

#### **2.3.4: LEGITIMACY, EXTERNAL REGULATION AND REPORTABLE IRREGULARITIES: CRITICAL PERSPECTIVES**

---

Complex 'ceremonial displays' or 'institutional myths' are frequently used to justify to constituents that organisations make valid, useful or legitimate contribution to society (Meyer and Rowan, 1977). For the audit profession, whose entire technical process culminates in only a single, highly standardised report on a client's financial statements (IAASB, 2009s), this may be no exception. For example, the audit profession seeks formal charters or legal backing for its services (Power, 1994; Power, 1997; Power, 1999). In attempting to expand its jurisdictional claims, appeals are made to notions of pragmatic and moral legitimacy by demonstrating the utility of the respective services or by attempting to enlist the support of powerful stakeholder groups to champion new lines of service (Power, 1997; O'Dwyer et al, 2011). Operationally, the profession relies on highly trained staff, professional standards subject to due process, claims to independence and a balance between prudential professional judgement and quasi-scientific audit process to rationalise audit practice, albeit that this remains largely invisible to all but the audit firm itself (Humphrey and Moizer, 1990; Power, 1992; Power, 1995; Sikka and Willmott, 1995). In short, the audit profession becomes an example of a highly institutionalised, socially constructed, technical practice (Power, 2003; Humphrey, 2008).

Attempts to 'control and coordinate the activities in institutionalized organisations [however] leads to conflicts and loss of legitimacy' with the result that 'elements of structure are decoupled from activities and each other' (Meyer and Rowan, 1977, p. 357). To this end, organisational purpose is left deliberately vague and little effort is dedicated to defining clearly technical performance (Hopwood, 1990). Concurrently, the evaluation of actual achievements against well-defined benchmarks is replaced by 'ceremonial' forms of inspection and evaluation (Meyer and Rowan, 1977; Ashforth and Gibbs, 1990; Suchman, 1995).

'The advantages of decoupling are clear. The assumption that formal structures are really working is buffered from inconsistencies and anomalies involved in technical activities. Also, because integration is avoided, disputes and conflicts are minimised, and an organization can mobilize support from a broader range of external constituents' (Meyer and Rowan, 1977, p. 357).

MacLulich (2003) provides an audit-specific example. The emergence of risk-based audit regimes appeals to the ideal of flexible application of judgement; offers additional value for clients by identifying control deficiencies; and stresses the importance of a more rational approach to audit testing (see also Power, 2003; Khalifa et al, 2007). In reality, however, this amounts to little more than impression management - 'reconfiguring' standard 'audit discourse' as a 'discourse of assurance' (MacLulich, 2003, p. 808). Practitioners apply detailed checklists, effectively reducing professional judgement to a sequence of processes to ensure adherence to 'best practice' (Fogarty, 1992; McMillan, 2004) or a quasi-scientific method (Power, 1992; Power, 2003) that legitimises the attest function. To further win public confidence, cautionary language is stressed with the introduction of 'assurance', 'audit comfort', 'quality control' and 'risk-management' introduced to audit parlance (MacLulich, 2003; Khalifa et al, 2007; Humphrey, 2012).

Where reliance on audit is rooted in rituals of verification (Power, 1995), the use of jargon and clever imagery conjures up belief in a highly professional, well defined, carefully researched approach to audit practice that secures claims to pragmatic, moral and cognitive legitimacy (consider Hopwood, 1990; Sikka and Willmott, 1995; Sikka et al, 1998; Pentland, 2000; Power, 2003; Sikka, 2004). The 'reform', however, ignores the importance of tackling auditor independence problems (Low et al, 2008) and the need to cultivate *bona fide* professional skills (McMillan, 2004; Wyatt, 2004). Instead it leaves 'existing structures intact without any substantive change in operationalisation of (autonomous) judgement' (MacLulich, 2003, p. 808).

Fogarty et al (1991) adopt a similar perspective. In response to a perceived expectation gap, the researchers elaborate on how the audit profession adopts professional standards that take some steps towards creating fraud-related responsibilities for the practitioner. Despite this, no guidelines on how these responsibilities are to be implemented practically are issued; audit practice remains largely unchanged; and the training of audit professionals refrains from adopting a focus on the need for fraud detection. 'Accepting responsibility for fraud in the absence of any realistic prospect of detection forms a classic instance of decoupling under institutional theory' (Fogarty et al, 1991, p. 206). This *modus operandi* allows the profession to be placed in a 'positive space' where it simultaneously accepts responsibility for resolving the expectation gap with additional education while abrogating

responsibility for effecting material amendments to existing audit practice (Sikka et al, 1998). During the 18<sup>th</sup> and early 19<sup>th</sup> century, the role of the auditor in addressing fraud risk is emphasised in order to win legitimacy for the emerging profession (Chandler et al, 1993). As audit becomes more institutionalised, the fraud detection function is effectively downplayed - decoupled from the main purpose or objective of audit which relies on claims to independence, professional competency and expertise to secure continued credibility (Humphrey and Moizer, 1990; Sikka et al, 1998).

Fraud-associated responsibilities cannot be totally eliminated due to the generally held belief that, at least to some extent, auditors ought to play a role in the detection and prevention of fraud (see for example Humphrey et al, 1993a; Dennis, 2010; Porter et al, 2012). Consequently, the profession has historically engaged in a delicate balance between appearing to accept increased responsibility for fraud detection and prevention, while not overtly accepting a formal duty to seek out fraud actively. This has successfully created the impression that the audit fraternity remains committed to serving the public interest and that it is accepting the need for change in response to mounting criticisms. Juxtaposed with this is the practical reality of audit practice left largely unaltered and defined in complex, obscure technical terms that successfully detract from the need for additional reform (Humphrey et al, 1992; Power, 1994; Sikka et al, 1998).

Likewise, where audit failures occur, the profession is wont to attribute this to an isolated occurrence or to the actions of rogue individuals (Sikka et al, 1998; Mitchell and Sikka, 2002; Unerman and O'Dwyer, 2004). It tends to respond with revisions to professional standards and a surge of publications and press releases aimed at educating the misinformed public of the 'true' nature and scope of the assurance service (Byington and Sutton, 1991). Again, these efforts serve a mainly symbolic purpose. They do little to change audit significantly on the ground, while cultivating the belief that the audit community is aware of and responding to the concerns of key constituencies (Humphrey et al, 1992; Sikka et al, 1998; Humphrey, 2012). Paradoxically, these professional standards and pronouncements dare not be too specific in case their 'mystical' properties be undermined (Hopwood, 1990; Humphrey et al, 1992, p. 149).

By effectively 'decoupling' operational changes from the image of a high quality assurance function that strives to serve the public interest, the audit profession is able successfully to preserve its claim to legitimacy (Humphrey and Moizer, 1990; Humphrey et al, 1992) while simultaneously appearing to take on additional responsibilities so that the emphasis is on the potential of audit services rather than actual practice (Hopwood, 1987; Humphrey et al, 1992). As explained by Power (1994, p. 39) a sharp contrast emerges between the image of

auditing championing accountability and transparency and a professional function that is 'often very specialised and opaque to a wider public'. Audits may provide comfort to stakeholders who are remote from day-to-day practices but the operation of complex institutional processes tends to deter more extensive enquiries and may render audit a powerful 'form of image management rather than a basis for substantive analysis' (see also Humphrey and Moizer, 1990; Sikka et al, 1998; Unerman and O'Dwyer, 2004; O'Dwyer et al, 2011). These examples confirm the theorisations of Meyer and Rowan (1977):

'Societies promulgate sharply inconsistent myths' leaving organisations to 'link the requirements of ceremonial elements to technical activities and to link inconsistent ceremonial elements to each other' (Meyer and Rowan, 1977, p. 356).

Seldom are the ceremonial requirements ignored during this 'reconciliation' process, for ceremonial requirements are an important source of moral or cognitive legitimacy (Meyer and Rowan, 1977; Suchman, 1995; Power, 2003). By the same token, underlying technical activities are also an important source of legitimacy which an organisation would also be reluctant to dispense with (Meyer and Rowan, 1977; Fogarty, 1992; Power, 1994). As a result, a process of 'decoupling' is followed in terms of which technical activities are separated from carefully cultivated 'myths' allowing the organisation to operate efficiently according to its defined technical standards while simultaneously maintaining a perceived alignment with cultural or societal expectations (Meyer and Rowan, 1977). Effectively, this allows the organisation to carry on with day-to-day technical activities while maintaining face with important constituents.

In this context, that external regulation can be used to *bona fide* improve audit quality, as suggested in Section 2.2, and thus bolster the credibility of the audit profession has not been universally accepted (McMillan, 2004; Messner, 2009; Powell, 2010; Mitra and Hossain, 2011). Under the lens of institutionalism, auditor regulation does not guarantee enhanced operating efficiency (see also Fogarty et al, 1991; Al-Twaijry et al, 2003). Instead, exogenous control of the profession may be an example of the 'formal structures' that 'reflect the myths of...institutional environments' (Meyer and Rowan, 1977, p. 341).

As theorised by Sikka et al (1998), Humphrey (1992) and Power (1994) it may, be that arms-length regulation becomes part of a process of decoupling. The enactment of new laws suggests that underlying problems contributing to a decline in audit quality are resolved. At the technical level, audit remains an opaque process (consider Power, 2003; Francis, 2004; McMillan, 2004), which naturally begs the question: how can an external regulator hope to understand the audit process and define the relevant mechanisms to improve audit quality? With audit being socially and contextually driven there is no precise definition of the nature

and purpose of audit. This implies that external regulation may simply reflect the 'aspirations' of regulators (Power, 1994) or hopes for the 'potential' (Burchell et al, 1985; Hopwood, 1987) of audit practice which allay the fears of uniformed users and allows the technical operations of audit to remain unchanged and left incapable of direct contrast against social expectations (Fogarty, 1996; Sikka et al, 1998; Unerman and O'Dwyer, 2004; Humphrey, 2012). Consequently, when it comes to external regulation, it may well be a case of 'actively and influentially mobilis[ing]' conceptions of reform to the point where regulation *itself* becomes more relevant than the regulated practice (Hopwood, 1990, p. 84). More critical interpretations are also possible.

On the one hand, regulations aimed at improving audit quality may be impacted by the agendas of powerful constituents including the pressures and incentives faced by regulators (Watts and Zimmerman, 1979; McMillan, 2004; Laughlin, 2007; Humphrey, 2008). On the other, there is the risk of simply creating the impression of active reform while underlying problems remain unresolved (Meyer and Rowan, 1977; Humphrey and Moizer, 1990; Power, 1994). Unerman and O'Dwyer (2004), for example, argue that regulatory reaction to corporate failures tends to defend the auditing system often avoiding more stringent measures until perceived levels of trust are so materially threatened that the expert system would no longer be able to ensure the functioning of capital markets. In other words, regulators tend to shy away from actively tackling perceived audit quality problems (Power, 1994; Unerman and O'Dwyer, 2004; Pesqueux, 2005). As a result, external auditor regulation may be nothing more than a ruse used to create the impression of control, doing little to address the underlying problem of excessive capitalistic pressures leading to compromised audit quality (Humphrey and Moizer, 1990; Wyatt, 2004; Pesqueux, 2005; Sikka et al, 2009; Bayou et al, 2011). Accordingly:

'Audit can be likened to a shiny black box on the surface of which the aspirations of new regulatory programs can be reflected and made possible...[but] it is undesirable to look beneath the surface of audit practice into the box...[because] regulators do not want to know what auditing really is' (Power, 1994, p. 25).

This corroborates the position referred to by Laughlin (2007), Humphrey (2008; 2012) and McMillan (2004): that reform may simply be a means of *superficially* legitimising and fostering confidence in accounting and auditing systems if it is convenient to do so. As explained by Unerman and O'Dwyer (2004, p. 988), a 'withdrawal of non-expert trust...risked compromising the operation of investment markets, which are a key element underlying capitalism' and, thus, also important for the very context in which politicians operate. As such, preserving trust in accounting and audit systems is not just about reassuring financial market participants but is 'also clearly in the self-interest of many regulators'. In particular, a

failure to respond could result in a severe challenge to the legitimacy of the capital system, eroding state revenues and threatening 'the comfortable...roles occupied by many of these regulators' (Unerman and O'Dwyer, 2004, p. 988).

From this perspective, policy developments may be seen as 'buttress[ing] preconceived notions' or agendas (Watts and Zimmerman, 1979, p. 274). The enactment of laws, purportedly aimed at improving audit quality, may be used in a similar way - as a means of 'marketing' claims to societal interest while primarily being about finding a 'quick-fix' to ensure political support (Unerman and O'Dwyer, 2004). What legislation, like SOX, may allow politicians to do is create the illusion of proactive measures to improve audit practice. While useful for winning votes, the *modus operandi* does very little to improve audit quality (see also Dollinger, 2012). Indeed, audit quality may never have been an issue for the legislators. For them, legitimacy may be fostered by the impression of acting in the public interest (see Kaplan and Ruland, 1991; Unerman and O'Dwyer, 2004; Farrar, 2011).

Similarly, Suchman (1995) explains how organisational legitimacy is often used as a 'resource' to garner support for firms and how 'self-serving claims of moral propriety' are employed to 'buttress these claims with hollow symbolic gestures' (Suchman, 1995, p. 579). By inference, the same may apply to legislators. Regulation presented as seeking to improve audit quality may amount to 'hollow gestures' designed to allay public concerns about the sound functioning of capital markets on which governments themselves are dependent (consider: Power, 1994; Unerman and O'Dwyer, 2004; Humphrey, 2008). Alternately, auditor regulation can be interpreted as a simple means of, 'isolating' audit from the rest of the free market system to signal government's concern and recognition of society's fears regarding the soundness of audit processes with the aim of persuading constituents to continue trusting capital markets (adapted from: Suchman, 1995; Unerman and O'Dwyer, 2004).

The end result may be hastily enacted legislation that, firstly, has unintended consequences which detract from any quality-enhancing potential (Vakkur et al, 2010; Bronson et al, 2011); secondly tackles the symptoms rather than the cause of the underlying problem (Unerman and O'Dwyer, 2004; Vakkur et al, 2010; Bronson et al, 2011); or, finally, oversimplifies the issues at hand (Power, 1994; McMillan, 2004; Jenkins et al, 2006). Paradoxically, this may actually undermine legitimisation efforts (Power, 1995). Frantic and dramatic displays by governments following audit failures may impair decision making and 'dull' instruments of legitimisation 'that, if used with patience and restraint, might have saved them' (Suchman, 1995, p. 599). Consequently, legislation's potential to effect material change and provide a long-term source of legitimacy for auditing systems is questionable.

It may be possible that similar processes of decoupling are at work with the South African auditor's duty to report client transgressions. Although giving rise to an additional reporting duty, the RI provisions do not change audit practice (IRBA, 2006). No effort, for example, is made to resolve the expectation gap by creating a formal duty for auditors actively to detect fraud. By the same token, the legislation is unable to render audit processes more visible and, like risk-based audit procedures discussed by McLulich (2003), may do little to change how auditors internalise regulatory or professional developments. As such, the RI provisions may, in line with the arguments of Fogarty (1991), Humphrey and Moizer (1990) and Power (1994), amount to little more than a complex ceremonial process used by the legislature and audit profession to create the impression of active reform in the public interest, while the operational reality of external audit in South Africa remains largely unchanged.

In addition, the effect of more arms-length regulation may simply cultivate a compliance-driven mindset whereby new laws and regulations encourage a 'check-box' exercise rather than material reform for the benefit of constituencies (McMillan, 2004). Vakkur et al (2010), analysing the effects of SOX, for example, argue that, by encouraging a legalistic culture, SOX is reduced to simple acts of compliance. From this perspective, perceptions of adding value or conforming to societal ideals are by-products of self-serving compliance rather a *bona fide* source of legitimacy (consider Suchman, 1995; McMillan, 2004).

By analogy, s45 of the APA's prescriptive style (Section 2.1) raises the issue of whether or not the legislation truly enhances audit quality and perceived legitimacy or is simply a 'check the box exercise'. If an irregularity is reported, this is possibly to avoid sanctions for non-compliance rather than due to a sense of public duty or quest for higher levels of audit quality and transparency. Accordingly, can mandated whistle-blowing still serve as a quality or legitimacy enhancing tool? The RI provisions may simply be part of the process of superficially responding to crises of trust as discussed by, *inter alia*, Laughlin (2007), McMillan (2004) and Unerman and O'Dwyer (2004).

Miller and O'Leary (1987) and Carruthers (1995) provide an alternate, although related, explanation for developments in accounting systems which may explain the RI provisions. Consistent with Hopwood (1987), Burchell et al (1980) and Kaplan and Ruland (1991), accounting does more than just fulfil a neutral functional role. At the same time, there may be more at work than displays – whether symbolic, political, economic or otherwise – aimed at fostering a sense of legitimacy (Miller and O'Leary, 1987).



Under the lens of institutionalism, the relevance of power and control should not be overlooked (Carruthers, 1995). When one considers that s45 of the APA is underpinned by a prescriptive approach to blowing the whistle (IRBA, 2006); that an attitude of simple compliance, discussed previously, may be indicative of an enclosing-type control (see Roberts, 1991; McMillan, 2004); and that the duty is backed by sanctions for non-compliance (s52 of the APA, 2005; IRBA, 2006; IRBA, 2011; SAICA, 2012) the whistle-blowing duty becomes reminiscent of Foucauldian (Foucault, 1977) power and control. Each of these 'elements' gives rise to notions of the efficient body; detailed elaboration of acts; and a sense of normalising sanction. At the same time, a motif of surveillance is present in the potential of the RI provisions to render transgressions 'visible' (consider Hopper and Macintosh, 1993; Walsh and Stewart, 1993; Cowton and Dopson, 2002). From this perspective, it may be the case that notions of disciplinary power encourage 'normalising behaviour' on the part of auditors and their clients, reinforcing the argument that the reporting duty may positively impact audit quality (Section 2.2; Chapter 4; Chapter 5) or that it is a *bona fide* means of entrenching a sense of moral and pragmatic legitimacy (Chapter 6). On the other hand, a sense of Foucauldian power may simply be part of the ceremonial processes (Meyer and Rowan, 1977; Suchman, 1995) by which elaborate - and paradoxically subtle (Gordon, 1980) - displays of power are used to cultivate belief in the legitimacy myth that is s45 of the APA.

---

## 2.4: THE RI PROVISIONS: ELEMENTS OF PANOPTICISM?

---

Section 2.2 dealt with a rational, technical view of external audit as part of the system of checks and balances designed to mitigate agency costs. By attesting to the fair presentation of financial statements, the assurance function allows users to place confidence in financial reports, thereby allowing for efficient allocation of resources and reductions in the cost of capital (Jensen and Meckling, 1976; Francis, 2004; Clinch et al, 2012). In explaining the 'audit explosion' that has characterised modern society, Power (1994) and Pentland (2000), however, interpret audit as representing a move along a social continuum from a state of assumed confidence in the financial and investment system, to mounting distrust. At some point, non-expert users, unable to observe directly underlying processes or fully comprehend them, come to realise that an independent source of assurance is needed to ensure continued confidence in the capital market system (Chandler et al, 1993; Edwards, 2001; Unerman and O'Dwyer, 2004).

In order for audit to reassure stakeholders of the credibility of what Unerman and O'Dwyer (2004) describe as 'expert systems' it is, however, paramount that audit also command the confidence of constituents. To this end, Section 2.2 touched on the importance of audit quality, including the need for auditor independence in both fact and appearance (Chapter 4; Chapter 5). From an institutional perspective, Section 2.3 evaluated sources of legitimacy of the audit profession, a key aspect of which has been the role played by self-regulation in 'guaranteeing' the sound functioning of audit quality control systems and the standing of the profession (Edwards, 2001; Konar et al, 2003; Zeff, 2003a; Zeff, 2003b; Odendaal and De Jager, 2008). The self-regulatory ethos has, however, been challenged by numerous and repeated corporate scandals which, per Section 2.1 and Section 2.3, has led to calls for more arms-length control over audit practice and quality (Unerman and O'Dwyer, 2004; Gavius, 2007; Sy and Tinker, 2008; Bazerman and Moore, 2011; Zerni, 2012). In other words, audit – as a means of reassuring trust in capital markets – is itself no longer able to command the trust of constituents, setting the scene for exogenous control over the profession. A tension between trust and regulation results<sup>33</sup>.

Trust ought to reduce the need for external control by cultivating a relationship between parties where divergent interests are effectively narrowed (Black, 2008), something particularly important when the respective organisation or commercial context is complex, or obscure from the perspective of non-experts (Suchman, 1995; Unerman and O'Dwyer, 2004). As explained by Giddens (1990; 1991) trust is interconnected with a vague or partial understanding of abstract processes and expert systems culminating in a sense of 'faith' or belief in the underlying, despite the absence of definitive information to support these beliefs (Suchman, 1995). Yet, in order for non-experts to place their confidence in these systems, a battery of checks and balances is demanded, one of which is external audit (Power, 1994; Pentland, 2000). When corporate failures occur in the context of an already partially regulated environment, the response is the introduction of more controls with audit itself subject to additional regulation (Unerman and O'Dwyer, 2004; Malsch and Gendron, 2011). Ironically, the monitors become the monitored.

Arms-length regulation, introduced to reassure stakeholders or restore a sense of trust is, however, only required precisely because good faith belief in the respective expert system is lost (Black, 2008). Regulation, therefore, substitutes for a loss of trust, rather than cultivating it. Exogenous controls over the audit profession are tantamount to a 'reflexive' awareness of flaws in audit, simultaneously signalling an effort to restore trust in expert systems (Unerman and O'Dwyer, 2004) and the fact that trust *itself* is no longer adequate - that taken-for

---

<sup>33</sup> Special thanks must go to the participants and anonymous reviewers at the International Corporate Governance Conference (2012) for their comments on this aspect of the thesis.

granted belief in the system is lacking and that alternate means of legitimisation must be sought (consider Suchman, 1995; Mosso, 2003). This begs the question: what is it about external regulation that leaves stakeholders favouring it over the audit profession's self-regulatory franchise?

As per Section 2.3, it may be the case that external regulation legitimises the profession, creating a 'firewall' between prior failures and the current efforts of the practitioners. Whether actual or symbolic, external regulation is able to ensure the continued support of stakeholders (Chapter 6). At the same time, external regulation may make a material contribution to audit practice and audit quality (Section 2.2; Chapter 4; Chapter 5). Alternately, what may make external regulation appealing to constituents is the presence of clearly defined rules that create a sense of control over the profession and which are backed by sanctions for non-conformance. In other words, motifs of disciplinary power may contribute to the case for external regulation, including s45 of the APA.

Similar to the change impetus of industrialisation that Foucault (1977) identifies as underpinning the move towards techniques of disciplinary power, it may be that the need for a perceived sense of 'visibility' or 'control' over the audit profession gives rise to Panoptic-like attributes of recently enacted external regulation. In other words, one reason for demands for arms-length regulation to replace the self-regulatory framework for the audit profession may be attributed to notions of disciplinary power. Motifs of surveillance, examination and normalising sanction, for example, may be at work in external regulatory developments reassuring users of audit reports that practical and socially desirable change at both the audit client and audit firm is taking place. As explained by Foucault (1977, p. 109) 'there must be no more spectacular but useless penalties'. Instead, disciplinary power should operate to clear economic and political ends (Gordon, 1980) such that 'everyone must be able to read in it his own advantage' (Foucault, 1977, p. 109).

---

#### **2.4.1: FOUCAULDIAN POWER AND CONTROL**

---

Foucault (1977) identifies three principles at the heart of disciplinary society: enclosure, notions of the 'efficient body'; and the principle of disciplinary power. In the first instance, there are specific locations in which the individual is enclosed or contained. General enclosures are partitioned allowing specific functions to be defined and for each person to be made 'known' - capable of assessment and ranking, according to the appropriate criteria, and hence capable of being controlled (Foucault, 1977; Gordon, 1980; Foucault, 1983;

Smart, 2002). The control-potential of the classroom is an example with students assigned to specific functional places characterised by strict hierarchies and the role of examination (Hoskin and Macve, 1986).

Once individuals are 'enclosed in identifiable, ranked, serialised and functional spaces, the principle of the efficient body can be brought to bear on them' (Hopper and Macintosh, 1993, p. 194). Central to this is the timetable which defines when specific activities in each functional space take place with an aim to ensuring an efficient use of individuals' limited time. This is complemented by the 'temporal elaboration of the act' used to specify the precise way in which an act is performed (Foucault, 1977; Gordon, 1980) ensuring that 'the detailed prescriptions (the knowledge) carried in regulation (the disclosure) and imposed on each individual (power) [convert] him or her into a manoeuvre...' (Hopper and Macintosh, 1993, p. 195).

Finally, for principles of enclosure and the efficient body to be effected successfully, Foucault (1977) believed that disciplinary power was paramount. Accordingly, hierarchical surveillance, normalising sanctions and examinations become an inextricable part of the functioning of disciplinary society (Gordon, 1980; Hoskin and Macve, 1986; Hopper and Macintosh, 1993). In this 'enclosed space', sanctions for non-conformance are no longer only physical (Smart, 2002). They include a series of 'punishments' - routines, protocols and drills each aimed at subtly correcting and reducing non-conformity (Foucault, 1977; Gordon, 1980).

Hierarchical surveillance emerged in 18<sup>th</sup> century Europe from conceptions of a 'gaze' that constrained the individual (Miller and O'Leary, 1987; Hopper and Macintosh, 1993; Walsh and Stewart, 1993). Observation creates a sense of constant supervision underpinned by a system capable of relaying information on the observed. Key to this is that the system works on the behaviour of the individual without recourse to overt force but in a more insidious way (Foucault, 1977; Gordon, 1980). Disciplinary power is subtle or opaque on the one hand, but pervasive on the other, going almost unnoticed as it comes to be accepted as natural and inevitable (Gordon, 1980; Miller and O'Leary, 1987). In contrast to the 'watchers' who go unseen, the individual is rendered totally visible and, thus, manageable (Foucault, 1977; Hopper and Macintosh, 1993; Cowton and Dopson, 2002).

Accompanying this is a sense of examination and normalising judgement (Foucault, 1977; Gordon, 1980; Walsh and Stewart, 1993; Smart, 2002; Brivot and Gendron, 2011). As explained by Foucault (1977) and Hopper and Macintosh (1993), the functioning of hierarchical surveillance relies on a system of reward and penalty, complementing the traditional legal system by allowing previously undefined or largely ignored domains to be

subject to sanction for non-conformance with established norms (Foucault, 1977; Gordon, 1980; Foucault, 1983). Integral to this is the process of examination in terms of which the performance and output of the individual can be measured and assessed against predefined standards or expectations, allowing the 'abnormal' to be identified and then praised or punished accordingly (Hoskin and Macve, 1986; Hopper and Macintosh, 1993). Examination also results in the reduction of transgressions to writing effectively creating an 'archive' that can be used to describe and measure the cumulative performance of the individual (Hoskin and Macve, 1986; Hopper and Macintosh, 1993). In turn, technologies of surveillance differentiate between and rank different individuals, ensuring a constant pressure to conform (Hoskin and Macve, 1986; Hopper and Macintosh, 1993; Walsh and Stewart, 1993). In other words, mechanisms of disciplinary power can be seen as 'a set of practices which [can] be specified and which positively [produce] ways of behaving and predispositions in human subjects' (Goldhamer and Shils, 1939; Gordon, 1980; Hoskin and Macve, 1986, p. 106; McKinlay and Pezet, 2010).

In this way Foucauldian 'power' and 'control' are not singular actions, but something 'circulating throughout the social body' (Smart, 2002, p. 79). The aim is to render the individual 'objectified', 'visible' and subject to 'normalisation' (Foucault, 1977; Gordon, 1980; Foucault, 1983; Neimark, 1990; Roberts, 1991; Roberts, 2001; Smart, 2002; Roberts, 2009). A traditional view of having power over another by virtue of the ability to control physically or dominate another (Goldhamer and Shils, 1939; Molm, 1986; Molm, 1989; Walsh and Stewart, 1993; Smart, 2002) is superseded by 'a subtle, calculated technology of subjection' (Foucault, 1977, pp. 220-221). The primary focus is not on disciplining the body, as was the case with old monarchical society (Foucault, 1977; Miller and O'Leary, 1987) but on the development of the apparatus of surveillance, means of registration, and techniques of investigation, research and archiving of information, each deployed to 'useful' ends (Foucault, 1977; Gordon, 1980; Roberts and Scapens, 1985; Hoskin and Macve, 1986; Smart, 2002; Roberts et al, 2006). As explained by Smart (2002, p. 87):

'Such a relationship of visibility, **or even potential visibility**, has constituted an important technique through which discipline has come to be exercised over the individual in a variety of institutions' (emphasis added).

This more subtle (Smart, 2002) aspect of disciplinary power is often described in terms of Bentham's Panopticon. Here, power emanates from the fact that individuals are restricted to an enclosed space, subject to actual or perceived surveillance by an apparently ever-present and invisible observer. The result was the development of a 'consciousness' of surveillance; an automated disciplinary effect; and the rendering of constant observation unnecessary

(Foucault, 1977; Gordon, 1980; Hopper and Macintosh, 1993; Walsh and Stewart, 1993; Cowton and Dopson, 2002; Smart, 2002; Gumb, 2007). In essence:

'Disciplinary power moves the focus of control to individuals themselves; that is, by understanding that they are constantly under surveillance, individuals begin to oversee themselves, to regulate their own behaviour in the light of its assumed visibility to others....The functioning of power becomes automatic rather than as a result of a conscious exercise by some external agency' (Cowton and Dopson, 2002, p. 193).

Bentham, therefore, 'invented a technology of power designed to solve the problems of surveillance' and believed that the 'optical system was *the* great innovation needed for the easy and effective exercise of power' (Foucault in Gordon, 1980, p. 148). The panoptical metaphor is not, however, without its limitations. For example it implies a sense of enclosure of a limited number of individuals who are monitored for discreet departures from an established norm, often in a physical sense (Smart, 2002). It has, therefore, been able to provide fruitful insights into the operation of relatively simply and physically enclosed factories at the start of the Industrial Revolution (Walsh and Stewart, 1993). Modern writers, however, question whether the ability to gather, store and analyse data for transgressions by *all* individuals by an increasingly computer-based society goes well beyond the monitoring of delinquent factory workers in 18<sup>th</sup> and 19<sup>th</sup> century Europe (McKinlay and Pezet, 2010; Brivot and Gendron, 2011). An information technology society is a far cry from the bounded Panopticon where monitoring could be constrained 'to specific geographical or temporal enclosures' (Brivot and Gendron, 2011, p. 139). Advances in information technologies and communication systems mean vast new modes of surveillance expanding on the single panoptic gaze may be possible (Haggerty et al, 2011). Similarly, modern society may no longer be characterised by a single clear surveillance plan operating in well-defined or enclosed spaces (Gordon, 1980; Brivot and Gendron, 2011; Haggerty et al, 2011).

Significantly, Foucault himself cited a failure to recognise the importance of resistance as 'another of the factors which shift Bentham into the domain of the unreal' (Foucault in Gordon, 1980, pp. 162-163), a sentiment shared by *inter alia* Brivot and Gendron (2011), Haggerty *et al.* (2011), McKinlay and Pezet (2010), Gumb (2007) and Hopper and Macintosh (1993). Foucault goes on to describe the belief that disciplinary mechanisms, in particular surveillance, could have a transformative effect causing individuals to become virtuous, as naive (Foucault in Gordon, 1980, pp. 162-163). Resistance to the panoptic gaze implies that much of the perceived value and impact of the Panopticon may be illusory (Gordon, 1980; Smart, 2002) a notion explored in more detail below. What is more, Neimark (1990) argues that Foucauldian theories may be too 'Eurocentric'. She asserts that they have possibly offered an alternative to traditional positivist outlooks that come to constitute a new and

constraining form of 'orthodoxy' which lacks critical bite and, accordingly, fails to provide a sufficiently thorough account of social phenomena.

Despite these criticisms, however, the essence of Bentham's Panopticon: that actual or perceived surveillance has an effect on human behaviour, remains relevant (Gordon, 1980; Hoskin, 1994; Cowton and Dopson, 2002; Brivot and Gendron, 2011). Foucault never claimed that *Discipline and Punishment: the Birth of the Prison* (or the Panopticon) provided a complete account of disciplinary power or mechanisms of modernity (see, for example, Hopper and Macintosh, 1993; Smart, 2002). Accordingly, although Foucauldian theory and the notion of the Panopticon are not without their limits (McKinlay and Pezet, 2010; Brivot and Gendron, 2011), Foucault is often cited as providing a seminal account of a power-knowledge paradigm and the role of technologies of surveillance (Gordon, 1980; Smart, 2002; McKinlay and Pezet, 2010; Haggerty et al, 2011). In direct challenge to Neimark (1990), Hoskin (1994) maintains that Foucault's works, far from being limited to historic French settings, explicates the operation of technologies of surveillance, discipline and examination. Concurrently, it sheds light on power-knowledge paradigms and social *practices* in general. The focus is not, therefore, simply on history or language (Neimark, 1990) but on the relevance of *discourse* and the making of the individual 'known', 'measurable' and subject to change (Hopper and Macintosh, 1993; Hoskin, 1994; Quattrone, 2004). Consequently,

'attempt[s] to box in Foucault will not hold. For he was not...a philosopher of power and language. Instead, he continues in the line of those....who have been concerned via rational analysis to understand how, as thinking, speaking, acting beings, we both construct and are constructed by our world' (Hoskin, 1994, p. 69).

Rather than dismiss Foucault, inherent shortcomings of his theory of power and control simply imply that disciplinary power, and in particular Panopticism, does not provide a complete account of studied phenomena (on the need for 'theoretical eclecticism', see Llewelyn, 1996; Llewelyn, 2003; Brennan and Solomon, 2008; Humphrey, 2008; Coldwell, 2012; Gibbon, 2012). The theory does, however, provide a fresh and critical insight into organisational and institutional forces beyond the narrowly defined perspective of traditional positivist research and has made a valuable contribution when applied in a management or accounting context (Moore, 1991; Hoskin, 1994; Quattrone, 2004). As such, Foucault's 'model' (Hopper and Macintosh, 1993) of power and control gives a reasonable framework for exploring the rationale behind the RI provisions.

---

#### 2.4.2: POWER AND CONTROL IN AN ACCOUNTING SETTING

---

Although Foucault did not deal directly with accounting and management (Miller and O'Leary, 1987), some scholars have interpreted his work, particularly *Discipline and Punish: The Birth of the Prison* (1977), as a lens for 'viewing' accounting systems (Hoskin and Macve, 1986; Miller and O'Leary, 1987; Hopper and Macintosh, 1993; Walsh and Stewart, 1993; Cowton and Dopson, 2002; Gumb, 2007; McKinlay and Pezet, 2010; Haggerty et al, 2011). Hoskin and Macve (1986), for example, argue that many West Point graduates went on to managing the emerging railroad industry taking with them West Point's system of surveillance, examination, discipline and punishment which later spread to other industries. For these researchers, management accounting become an integral part of the power-knowledge-disciplinary practices described by Foucault (1977), a construct of accounting systems echoed by Miller and O'Leary's (1987) view on standard costing as a mechanism of rendering individual inefficiency 'visible' and workers more accountable as a result.

Similarly, rather than seeing developments in accounting as the sole product of rational economic forces, Hopwood (1987, pp. 212-214) describes how the construction of an organisational and social order underpin accounting systems. Accountancy, far from being a passive form of technical administration and a neutral repository of information (Section 2.3), becomes a means of attaining 'economic visibility' to 'positively enable the governance and control of the organisation along economic lines'. From this perspective, an organisation's, 'routine procedures' immerse the employee in 'a disciplinary, punishable web of discourses and practices which go on almost unnoticed and appear as natural' (Hopper and Macintosh, 1993, p. 190).

Cowton and Dopson's (2002) case study of a manufacturing concern highlights this. The prison cell becomes a loose metaphor for the actual or abstract 'spaces' assigned to employees, including different layers of managers, who are then subject to calculative norms and standards. 'Enclosure' is not necessarily about the physical confinement of the individual (Gordon, 1980; Smart, 2002) but rather about specification of a clearly defined purpose that dictates not only when and how the individual should act, but what it means to be a member of the respective institution or organisation (Fogarty, 1992; Hopper and Macintosh, 1993; Cowton and Dopson, 2002). Cowton and Dopson (2002) go on to explain how accounting and management control systems make individual managers personally accountable for financial performance, effectively constituting a discourse for describing individual performance and rendering each person 'known' and controllable. Each profit centre or accounting function becomes an 'enclosed space' where the rules of accounting, costing,



production and efficiency define appropriate conduct and provide a basis for measuring performance. In this context, the accounting system plays a role, not just in collecting and processing information but in the very construction (enclosure) of knowledge at the heart of how the organisation is run (Miller and O'Leary, 1987; Hopper and Macintosh, 1993)<sup>34</sup>.

Analogously, Hopper and Macintosh (1993) draw a parallel between Foucault's (1977) principle of enclosure and creation of profitability centres at International Telephone and Telegraph (ITT) where managerial control systems and the 'discipline of the numbers' are used to similar effect. In both studies, prescribed roles, budgets and hierarchies define the spaces within which tasks are executed facilitating accountability and 'normalising correction' (Boland, 1987; Miller and O'Leary, 1987; Walsh and Stewart, 1993; Drury, 2005; Roberts et al, 2006). At ITT, in particular, Foucault's efficient body principle can be seen in the requirement for each profit centre to submit its annual budget; scheduled meetings at which results would be reviewed by senior management; and the generally temporal focus of the accounting system. Each aspect is an example of how a regimented 'time table' of controls is used to achieve a sense of order (Hopper and Macintosh, 1993) and of how accounting systems play a role, not just in collecting and processing information, but in the very construction of knowledge at the heart of how the organisation is run (Miller and O'Leary, 1987).

For the principle of enclosure to be effective, partitioning is needed to ensure that each person is capable of being 'known' and 'mastered' within each functional space (Foucault, 1977). The result is the creation of a series of posts or tasks facilitating supervision, ranking of individuals and enhanced functionality (Gordon, 1980; Smart, 2002). Enclosed spaces are 'idealised' - rather than physical - and designed to organise and achieve a sense of control and order. From the accounting perspective, the presence of partitioning is seen in the establishment of hierarchical management structures, defined 'posts', 'job descriptions', and ever more refined budgeting and monitoring systems (see Hopper and Macintosh, 1993; Cowton and Dopson, 2002; Drury, 2005; Botten, 2009).

Further, the principle of the efficient body (Foucault, 1977) suggests that timetables, operating manuals, and the 'temporal elaboration' of acts (Hopper and Macintosh, 1993, p. 195) are designed to perpetuate the sense of control and order. Annual budgets must be submitted at prescribed times (Hopper and Macintosh, 1993; Botten, 2009); budgets and

---

<sup>34</sup> To a lesser extent, the prior literature makes a similar case with the application of IFRS. As an example of codified accounting standards applied in multiple jurisdictions, IFRS may be seen as a source of Foucauldian power by constituting a dominant accounting 'discourse' that is used to both conceptualise and justify accounting-related issues (consider Hopwood, 1990; Fogarty, 1992; Rodrigues and Craig, 2007; Smith-Lacroix et al, 2012).

operating plans need to focus on defined areas within the organisation (Ouchi, 1979; Hopper and Macintosh, 1993); accounting reports need to be prepared according to predetermined guidelines (consider Ashton, 1992; Bedard et al, 2008); and there are strict hierarchies observed when reporting information (Botten, 2009) such that 'information flows up the chain and orders flow down' (Green (1984) in Hopper and Macintosh, 1993, p. 197).

Concurrently, prescribed roles, budgets and hierarchies define the spaces within which tasks are executed, facilitating visibility, accountability and 'normalising correction' (Boland, 1987; Miller and O'Leary, 1987; Walsh and Stewart, 1993; Roberts et al, 2006). For instance, profit centres become obliged to submit annual budgets and schedule meetings at which results can be reviewed by senior management at prescribed times, leaving accounting systems characterised by a strong temporal focus. In other words, a regimented 'time table' of controls is used to complement a sense of surveillance and order (Hopper and Macintosh, 1993). The creation of formal structures contributes to defining the role and purpose of the individual (Fogarty, 1992). Formalisation, centralisation, and notions of the 'timing of actions' have an important socialising effect on the individual, the effect being described as a form of 'bureaucratic coercion' and a possible source of disciplinary power.

Notions of disciplinary power, particularly conceptions of an 'all seeing gaze' in an organisational setting, is illustrated in Cowton and Dopson's (2002) case study which demonstrates how review by senior management can have an individualising effect (see also Roberts, 1991; Fogarty, 1992), allowing individuals to be held accountable and subject to sanction. The authors describe the automated management control system as a 'keyhole' through which management can 'peer' into the organisation's different branches simultaneously offering 'continuous accounting' to evaluate actual performance against targets and to develop expectations. The result is the possibility of assessment at a moment's notice (Roberts and Scapens, 1985; Cowton and Dopson, 2002) and intervention 'at a distance' (Cowton and Dopson, 2002; Drury, 2005; Brivot and Gendron, 2011, p. 138). Similarly, Hopper and Macintosh (1993) provide a detailed account of how profit centres may be used to render management's performance transparent and subject to inspection or examination at any time. Central accounting headquarters become akin to a 'panoptic tower', where monthly accounting and operational reports are continuously reviewed and different responsibility centres are duly assessed and ranked according to perceived functional utility. Those who meet expectations are rewarded. The converse is also true. Leadership by example is used, together with traditional control systems, to 'set the norm' and effectively cultivate a 'discipline of the self' – as postulated by Roberts and Scapens (1985), Smart (2002) and Roberts (1991; 2006) – resulting in 'normalising' behaviour.

Although Foucauldian constructs of power and control, especially panoptic imagery, may not account entirely for the nature and extent of digital surveillance made possible by sophisticated management and accounting systems, Foucault's work can be 'meaningfully mobilized in examining surveillance from a broader angle' (Brivot and Gendron, 2011, p. 137). Brivot and Gendron (2011) explore the relevance of discipline-induced surveillance in a study on the introduction of knowledge management systems in a professional law firm. The possibility of being watched, plausible due to the rendering of various working papers 'visible' to one's peers, was found to be an important driver of behavioural change. Underlying this is the risk of sanction including the fear of being branded a poor professional. It is not only that performance is made 'visible' to superiors and may result in some form of punishment or praise that is relevant, but also the fact that the *individual may be personally* contrasted with the accepted norms (Walsh and Stewart, 1993; McMillan, 2004; Wyatt, 2004; Roberts, 2009). The mere possibility of being watched suggests that, theoretically, one may be held individually accountable whether or not this actually transpires and that this can result in 'self-monitoring' even in sophisticated professional contexts (Cowton and Dopson, 2002; Roberts, 2009; McKinlay and Pezet, 2010).

---

#### 2.4.3: AUDIT AS A SURVEILLANCE MECHANISM

---

Disciplinary forces at work in a professional law firm may be mirrored in a professional audit setting. Audit has its roots in the Latin term meaning 'to hear', originating from a formal reading-aloud of the accounts. It serves as a form of examination providing a 'power of judgement' based on numeric results and expectations that allows stewards to be held accountable (consider Hoskin and Macve, 1986; Power, 1994). In line with agency theory, audit is designed to render financial information more visible, resolving information asymmetries between managers and shareholders (consider Watts and Zimmerman, 1976; Power, 1994; IAASB, 2009m; Lin and Liu, 2009; Solomon, 2010; Clinch et al, 2012). At the extreme, 'audit has assumed the status of an all-purpose solution to problems of administration and control' becoming akin to a 'control' over 'controls' (Power, 1994, p. 38 & 39) to the extent that alternate mechanisms of supervision, monitoring and control are left unthinkable (Humphrey and Moizer, 1990; Power, 1994). Accordingly audit may be seen as another example of a surveillance-based mechanism at work and reminiscent of Foucauldian power and control.

A converse may also apply. When corporate failures occur, 'reassurance is expected and deep-level changes are demanded', often manifested in the demand for additional regulation that has both preventative elements and which serves as an effective deterrent mechanism (Tremblay and Gendron, 2011, pp. 259-260). Increasingly, professional service firms are subject to calls for improved transparency and accountability following publicised corporate scandals which has seen the ascendancy of formal controls and the recognition of the importance of surveillance mechanisms (see, for example, Unerman and O'Dwyer, 2004; Bazerman and Moore, 2011; Brivot and Gendron, 2011; Paisey and Paisey, 2012). From the perspective of the audit profession, when corporate scandals begin to challenge the wisdom of the self-regulatory framework (see, for example, Zeff, 2003a; Zeff, 2003b; Pesqueux, 2005; Windsor and Warming-Rasmussen, 2009), external regulation may be interpreted as a manifestation of power aimed at stimulating behavioural or procedural change in the public interest (Canada et al, 2008; Riotto, 2008; Sy and Tinker, 2008; Carcello et al, 2011; Blankley et al, 2012; Paisey and Paisey, 2012). As an indication of isomorphic forces (DiMaggio and Powell, 1983), the number of auditor-specific regulations, including new regulatory bodies to secure the credibility of the attest function, have mushroomed (Malsch and Gendron, 2011). In this respect, Section 2.2 has already referred to how, in the USA and European Union, audit-focused regulations emerge, expanding on the existing reporting duties and how auditor rotation, appointment, remuneration, and ability to render non-audit services are subject to closer scrutiny and additional restrictions (Riotto, 2008; European Commission, 2010b; Deng et al, 2012).

From a legitimacy theory perspective, Section 2.3 suggests that arms-length regulation implies an increased sense of control over the profession, possibly conferring a sense of pragmatic and moral legitimacy (consider Gavigan, 2007; Sy and Tinker, 2008; Bazerman and Moore, 2011; Boolaky, 2011; Paisey and Paisey, 2012). Unerman and O'Dwyer (2004), for example, suggest arms-length regulation may accord a sense of transparency to audit practice by restricting audit conduct, simultaneously mitigating the effects of threats to auditor independence. If audit can be better 'contained' within the 'parameters' of regulatory efforts, which impose sanctions for non-conformance and mandate review of audit firms by independent regulators, then it may be possible for audit conduct to be aligned with notions of the public interest calling for credible, high quality external audit (consider PCAOB, 2006; PCAOB, 2007; Church and Shefchik, 2011; Clinch et al, 2012).

In this context, disciplinary power may fulfil an important function within the external regulatory paradigm. By appealing to a sense of transparency and accountability, while simultaneously restricting the activities of audit firms, panoptic-like control may provide an explanation for the demand for more arms-length regulation of the profession. As alluded to

in Section 2.2 and Section 2.3, examinations, surveillance and normalising sanctions may create a reasonable expectation of change in the aftermath of the audit fraternity's crisis of trust and contribute to either improving audit practice (Chapter 4; Chapter 5) or emphasising the perceived legitimacy of the audit profession (Chapter 6). This echoes the original views of Foucault (1977, p. 109) on the role of power and control in a modern context: 'there must be no more spectacular but useless penalties'. Instead, disciplinary power should operate to clear economic and political ends (Gordon, 1980) such that 'everyone must be able to read in it his own advantage' (Foucault, 1977, p. 109). Hence, the final sub-question addressed by this thesis asks:

***C. Is s45 of the APA an example of surveillance machinery and a manifestation of disciplinary power?***

Although the RI provisions may not correspond precisely with the image of the 'panoptic gaze', Foucault's model of disciplinary power may offer valuable insights into the rationale for the whistle-blowing duty<sup>35</sup>. The rigid structure inherent in its reporting protocols; clearly defined reporting timetables; creation of a reporting 'discourse' and sanctions for non-compliance (Section 2.1) may be reminiscent of Foucauldian elements of power and control. In particular, that the RI provisions are designed to bring otherwise unknown transgressions into the public domain (Section 2.1; Section 4.3) implies the possible operation of panoptic-like surveillance. *Prima facie*, the whistle-blowing duty may be akin to the 'keyhole' described by Cowton and Dopson (2002) through which observers may peer into certain aspects of the organisation. In turn, a network of surveillance may become possible (consider Gordon, 1980; Cowton and Dopson, 2002; Smart, 2002) enhancing transparency and accountability at the corporate level. By virtue of 'surveillance', 'examination' and 'normalising sanction' the reporting duty becomes more than just a theoretical one. It becomes practical or plausible, largely because of the consequences for non-compliance. If this is the case, then notions of power and control reinforce the initial arguments raised in Section 2.2 and Section 2.3: that the whistle-blowing duty may be a means of improving audit reporting standards and also affording a means of legitimacy.

---

<sup>35</sup> Power has been investigated using various approaches. For example, Luke's framework (cited in Malsch and Gendron, 2011) has been frequently employed. This paper uses a Foucauldian theoretical lens due to its focus on discourse and government which are relevant for examining the role of legislated auditor reporting (Malsch and Gendron, 2011). This approach also reflects the thinking in the comparable studies of Cowton and Dopson (2002) and Hopper and Macintosh (1993) which have inspired this aspect of the thesis. A detailed reconciliation of Luke's conceptions of power and control with those of Foucault, as well as an analysis of which 'model' is more conceptually rigorous, is beyond the scope of this research (Section 1.4.2).

---

#### 2.4.4: LIMITATIONS OF FOUCAULDIAN POWER AND CONTROL

---

The panoptic metaphor, while illuminating various nuances of management control and accounting systems, does not provide a complete assessment of institutional behaviour (Neimark, 1990; McKinlay and Pezet, 2010). In an organisational context, for instance, the relevance of market forces, relations with other organisations and the role of technology are not dealt with (Hopper and Macintosh, 1993; Brivot and Gendron, 2011). In particular, the Foucauldian model does not - as touched on previously - take cognisance of the relevance of resistance in shaping organisational change and behaviour (Gordon, 1980; Roberts and Scapens, 1985; Hopper and Macintosh, 1993; Gumb, 2007; Roberts, 2009).

Rather than provide complete visibility and control, systems of surveillance are frequently opposed whether overtly or otherwise (Gordon, 1980). Even where management controls come close to achieving a 'panoptic' gaze, a company may never be able to control totally its employees and, consequently, 'their resistance play[s] a crucial role in delimiting [organisations'] actions' (Hopper and Macintosh, 1993, p. 212). Similarly, Cowton and Dopson (2002) describe how panoptic control is not absolute. It is unable to influence totally the behaviour of all individuals who exhibit varied responses to the introduction of additional controls. Not all of these responses are conformist in nature. Even in a professional setting, where incentives for 'normalised' behaviour may be highest (Fogarty, 1992), resistance to a perceived 'gaze' may be present and play a relevant role in shaping individual behaviour. Brivot and Gendron (2011) demonstrate this in a professional law-firm setting. The researchers find that, while an awareness of surveillance does lead to some individuals altering behaviour as intended, subtle challenges to the *status quo* arise with the conclusion that control systems do not always lead to change in predictable ways.

Roberts (2009) and Roberts and Scapens (1985) reach a similar conclusion. The proliferation of accounting-based controls and the desire to make organisations 'auditable' (Power, 1994; Roberts, 2009) does not always lead to improved visibility. Management may be simply about 'keeping up appearances and fighting shadows' (Power, 1997, p. 838; Drury, 2005). Alternately, Roberts (1991; 2001; 2009) warns that the individualising effect of surveillance paradoxically promotes self-preservation and the desire to find and exploit 'gaps' in the field of visibility. For example, the introduction of fair value accounting - purportedly promoted with an aim to improving transparency and reliability of financial reporting - may, ironically, import 'cloudiness' into financial statements as preparers exploit inherent subjectivity in the determination of fair values (Smith-Lacroix et al, 2012). Likewise, the development of professional auditing and accounting standards characterised by

inherent complexity and subjectivity provides a basis for flexible or 'creative' application of underlying principles (Hopwood, 1990), particularly when a rules-based approach takes hold. These subtle forms of resistance may lead to a blind adherence to established norms cultivating a legalistic culture that undermines the potential of established policies and procedures (see McMillan, 2004; Wyatt, 2004). At extremes, the system may become reflexive with the pressures of imposed power becoming so severe that the system creates, or at least magnifies, the very self-serving *modus operandi* that it sought to quash (Power, 1994, p. 11; Roberts, 2001, pp. 1553-1554 & 1560).

In this light, while s45 of the APA may be an example of a disciplinary power mechanism, there is no guarantee that practical benefits are actually realised. In other words, Foucauldian theory of power and control would imply that the visibility or 'even the potential of visibility' is an important technique 'through which discipline is exercised over the individual' and behavioural change is effected (Smart, 2002, p. 87). Resistance, including a legalistic mindset, however, imply that the *practical* ability of the RI provisions to serve as an instrument of disciplinary power may be limited. This may be problematic for the argument that the reporting duty makes a material contribution to the quality of assurance practice in South Africa, as alluded to in Section 2.1 and discussed in detail in Chapter 4 and Chapter 5. Claims to pragmatic and moral legitimacy, as per Section 2.3 and Section 6.1, may also be undermined.

At a practical level, notions of hierarchical surveillance, normalising judgement and processes of examination are also problematic. Audit is heavily rooted in preservation of client confidentiality (IFAC, 2006; IAASB, 2009x) and the application of professional judgement by a group of individuals who cannot physically be subjected to perpetual surveillance or generically defined standards of professional conduct (McMillan, 2004; IAASB, 2009x; IAASB, 2009k; Rosman, 2011). From the perspective of s45 of the APA how can a sense of disciplinary power result if the IRBA is realistically unable to know whether or not the auditor detected every RI and hence reported it appropriately, if at all? By inference, how can sanctions be imposed on delinquent auditors? As argued by Debord, there is a contradiction between the mass of information available for collection and analysis and the capacity to do so (Debord, 1988 cited in Gumb, 2007) which undermines both actual surveillance and the power of assumed surveillance to yield, what Gordon (1980) and Roberts (1991; 2009) term, the 'discipline of self'. Inevitably in an apparent power-control relationship, a superior – in this case the independent regulator – will frequently be dependent on the subordinate (the auditor) for the provision of information, giving the opportunity to conceal, distort or 'dress' the information made available for assessment (Roberts and Scapens, 1985, pp. 449-450). As argued by Cowton and Dopson (2002) and

Brivot and Gendron (2011), the panoptic metaphor's sense of total control may, therefore, be illusory

Adding to the limitations of the RI provisions as an example of disciplinary power in action is an apparent contradiction. Foucauldian principles point to the possibility of the reporting duty being a means of rendering both the auditor and the audited more visible. Juxtaposed with this are the views of, *inter alia*, Power (1992; 1994; 2003) and Humphrey (1990; 2008; 2012): that legitimacy of audit practice is, paradoxically, intertwined with the inability of consumers of audit services to observe directly the audit process or objectively assess its findings.

More specifically, from an agency theory perspective, it was argued that the ability of external audit to improve transparency and address the risk of information asymmetry (Jensen and Meckling, 1976) is frequently cited as the reason for the growing relevance and legitimacy of external audit (Watts and Zimmerman, 1976; Power, 1994; IAASB, 2009; IAASB, 2009a; Solomon, 2010). The precise role of auditor in reducing these agency costs is, however, both complex and subjective, resulting in an 'expectation gap' (Gaa, 1991; Porter, 1993; Power, 1994; Dennis, 2010; Chambers and Payne, 2011; Houghton et al, 2011) that has the potential to undermine the perceived value of the assurance function (Section 2.2). Power (1994, p. 19), however, adopts a more critical view, suggesting that 'the audit explosion has occurred because of, rather than despite, expectation gaps about the nature of audit'. Ambiguity plays to the diverse role and need for audit, 'comforting politicians and a wider public that things are under control' (see also Hopwood, 1990). Accordingly, it is undesirable to render the audit process visible or transparent because its very opacity is integral to its generally accepted existence as a plausible element of the capital market system (Humphrey and Moizer, 1990; Power, 1994; Power, 2003; O'Dwyer et al, 2011).

A possible explanation for this tension is found by adapting institutional models of organisational behaviour elaborated on by Meyer and Rowan (1977), DiMaggio and Powell (1983), Fogarty et al (1991; 1992; 1996) and Suchman (1995). Formal structures including the South African auditor's whistle-blowing duties and associated penalty provisions may serve as powerful 'institutional rules which function as highly rationalised myths that are binding on particular organisations' (Meyer and Rowan, 1977, p. 343). Where this is the case, social purposes or societal expectations become more relevant than technical attributes (Meyer and Rowan, 1977) necessitating the decoupling of operational efficiency from the use of institutional processes or displays used to exploit the desires of constituents (Meyer and Rowan, 1977; DiMaggio and Powell, 1983; Suchman, 1995). The increased demands for external audit to serve as a monitoring function (Power, 1994), including



perceived fraud detection responsibilities (Fogarty et al, 1991) serve as a key example. These 'displays' ensure confidence in financial reporting while auditing 'on the ground' continues unchanged, its processes remaining obscure - and almost mythical - to non-experts (see also Humphrey and Moizer, 1990; Sikka et al, 1998; Humphrey, 2012). A similar line of thought was discussed in Section 2.3 which alludes to how the formal structure of the APA; its alignment with the notions of whistle-blowing as pro-social behaviour; prescribed 'legalities' or 'rules'; and a reporting duty that is backed by 'independent', 'technical' and 'professional' processes may be important symbolic efforts that afford legitimacy (Section 6.1). In the meantime, and as discussed in Chapter 4, the underlying technical nature of audit has been left largely unaltered (see also Humphrey and Moizer, 1990; Power, 1994; Power, 2003).

In the context of the RI provisions, reminiscent of Foucauldian power and control, an analogous conclusion may be reached. Rather than a practical source of disciplinary power, the RI provisions may be part of a ceremonial process which conjures up a 'mystique' embodying notions of surveillance, power and control to appeal to the cognitive belief in what Foucault (1977), Gordon (1980) and Smart (2002) describe as the 'disciplinary society'. That the RI provisions may or may not materially alter audit practice (Section 2.2; Chapter 4; Chapter 5); serve as a significant source of legitimacy for the audit profession (Section 2.3; Chapter 6); or constitute a source of disciplinary power to ensure actual reform, is not paramount. What is key is cultivating belief in the assumption that external regulation, including the mandated whistle-blowing duty, works (consider Meyer and Rowan, 1977; Suchman, 1995). In other words, s45 of the APA may, ironically, be a source of legitimacy – not due to changes made to audit practice in the public interest – but by appealing to a taken-for-granted assumption that examination, normalising judgement and panoptic surveillance provide a change impetus. At the heart of this is the fact that surveillance has become an integral and pervasive part of daily life (Gordon, 1980; Cowton and Dopson, 2002; Brivot and Gendron, 2011) regarded as generally accepted, plausible and 'natural'. As explained by Leon (2001, pp 3-4, cited in Brivot and Gendron, 2011):

'Surveillance always carries with it some plausible justification that makes most of us content to comply. [ . . . ] The fact that the camera is installed in the bar or at the intersection in order to reduce rowdiness or road accidents seems reasonable enough. [ . . . ] The advantages of surveillance for its subjects are real, palpable, and undeniable. We readily accept the point of it...'

This taken-for-granted belief in the utility of disciplinary power goes hand-in-hand with processes of mimetic isomorphism (DiMaggio and Powell, 1983). As discussed in Section 2.3 and Section 6.1 replicating a move towards external regulation may be an important

aspect of securing legitimacy for the South African Audit Profession. Seemingly championing the need for enhanced monitoring; sanctions for non-conformance; and enclosed reporting duties that appear to be taking hold abroad may reinforce this. The result: the RI provisions – by simply being *reminiscent* of Foucauldian power and control – create a sense of legitimacy. If this is the case, then exploring whether or not s45 of the APA is an example of disciplinary power in action needs to be carried out, not only from a Foucauldian perspective, but also through the lens of legitimacy theory (Section 7.2).

To do so, a more exploratory research method is required (Creswell, 2009) that is not restricted by reductionism and the aim to ‘quantify’ results (Ahrens and Chapman, 2006). As such, before proceeding with the discussion of the research findings, this thesis examines how more interpretive research is able to shed light on aspects of corporate governance left largely unstudied by the positivist research Establishment (Ahrens et al, 2008; Brennan and Solomon, 2008). Chapter 3 provides an overview of the role of ‘alternative’ research; details the research design; explains how respondents were selected for participation in the study; discusses the data collection and analysis process and summarises steps taken to ensure the quality and reliability of the findings.

---

### 3: RESEARCH METHOD AND METHODOLOGY

---

This study is grounded in a social constructivist world view and inspired by an interpretive epistemology. It adopts mixed methods relying on detailed interviews as the primary data collection instrument, complemented by a correspondence analysis to aggregate and summarise the perceptions on the RI provisions. In the context of defined theoretical frameworks (Chapter 2), the research focuses explicitly on the participants’ formulation of notions of audit quality, legitimacy and Foucauldian power and control associated with s45 of the APA.

This chapter is organised as follows: Section 3.1 provides an overview of the research methodology followed by Section 3.2 which discusses the design of the data collection instruments (detailed interviews and a correspondence analysis). Section 3.3 describes the sample of participants. Section 3.4 continues by explaining the data collection and analysis process, including steps taken to ensure high levels of research quality. Section 3.5 details a quality control checklist and discusses ethics safeguards and Section 3.6 concludes.

### 3.1: OVERVIEW

---

Ontology is concerned with the broad orientation of, or world view adopted by, a researcher and with how conceptions of reality are formed. Epistemology defines broadly how knowledge is gathered, a state of reality is interrogated and the subject matter of a research project is tackled (Creswell, 2009). Broadly, two epistemologies based on contrasting ontological perspectives can be discerned: positivist or non-positivist (interpretive) (Watts and Zimmerman, 1978; Ahrens et al, 2008; Creswell, 2009; Coetsee, 2011). The former is rooted in a 'deterministic philosophy' seeking to study cause and effect relationships 'at a distance' (Watts and Zimmerman, 1976; Falconer and Mackay, 1999). Often termed 'mainstream' research (Ahrens et al, 2008; Coetsee, 2011), it tends to 'reduce' the subject matter to a discreet set of defined ideas, questions or hypotheses, subject to scientific testing (Leedy and Ormrod, 2001; Creswell, 2009). The aim is to describe, explain and predict while maintaining objectivity and ensuring scientific rigour, with the result that positivist research projects tend to be more quantitative in nature (Watts and Zimmerman, 1978; Davila and Oyon, 2008; Creswell, 2009; Coetsee, 2011).

Interpretive research is concerned with understanding social constructions of a subjective reality and, thus, is traditionally reliant on qualitative methods (Parker and Roffey, 1997; Creswell, 2009). There is a higher degree of subjectivity which is seen as strength rather than a threat to result reliability (Creswell, 2009). Validity is not described in terms of reproduction of findings and clinical objectivity but rather in terms of immersion in rich detail which must be well documented to allow readers to reach informed conclusions (Inanga and Schneider, 2005; Ahrens et al, 2008; Baxter et al, 2008).

When it comes to accounting-based research, the prior literature argues that accounting and auditing systems are interconnected with organisational, institutional and social developments (Burchell et al, 1980; Hopwood, 1987; Humphrey and Moizer, 1990; Kaplan and Ruland, 1991; Hopwood, 2000; Parker, 2007; Humphrey, 2008). As such, they are far more complex than economic models initially allow for, with the result that more flexible, exploratory approaches are needed to illuminate different nuances of accounting and auditing (Moore, 1991; Quattrone, 2004; Ahrens and Chapman, 2006; Khalifa et al, 2007; Laughlin, 2007; Marnet, 2007; Baxter et al, 2008; Cooper, 2008; Humphrey, 2008; Carrington, 2010). In this context, interpretive research seeks to highlight 'the specific ways in which designers and users of accounting systems work with their constructive potential in the pursuit of specific agendas, and how their systems (and agendas) change in the process' (Ahrens et al, 2008, p. 842). A strong awareness of practical and social issues complements

this (Chua, 1986; Reiter and Williams, 2002; Alvesson, 2003; Inanga and Schneider, 2005; Parker, 2007; Ahrens et al, 2008; Davila and Oyon, 2008). Rather than strive to quantify results, seek complete objectivity, and pursue a unique 'truth' unaffected by the influences of different social factors (Ahrens and Chapman, 2006; Creswell, 2009), interpretive research concentrates on a rich analysis of behaviours and relationships in a real-world setting, especially in emerging areas of study (for example: Moore, 1991; Holland and Stoner, 1996; Holland, 1998a; Creswell, 2003; Willmott, 2008; O'Dwyer et al, 2011).

In this context, notions of audit quality, legitimacy and disciplinary power are highly subjective and reflect a host of social, organisational and institutional stimuli (Meyer and Rowan, 1977; Suchman, 1995; Roberts, 2001; Power, 2003; Unerman and O'Dwyer, 2004). Given the research questions, 'arms-length' analysis, using analytical modelling or event studies is inappropriate. These techniques do not allow the research to 'get as close to the phenomenon as possible to collect data on the primary....elements and how they are [interconnected]' (Holland, 2005, p. 250). In particular, when it comes to regulation of the profession, empirically-orientated research may, ironically, be questionable as numerous social, economic and political pressures are often at work that can 'lead to changes on the grounds of political necessity and expediency rather than being based on solid empirical evidence' (Humphrey, 2008, p. 181). Accordingly, this research does not attempt to 'test' audit processes along the scientific lines of, for example, DeAngelo (1981a; 1981b), Palmrose (1988; 1997), Chen et al (2011) and Blay and Geiger (2013). Instead, it adopts an exploratory approach based on the view that regulatory developments in an audit and accounting setting are not driven only by rational economic forces but are socially constructed (Burchell et al, 1980; Sikka, 1992; Power, 2003; Humphrey, 2008; Gibbon, 2012)

Illuminating the perspectives of those engaging with auditing on a daily basis can provide valuable insights for both academics and practitioners (Humphrey, 2008; Humphrey, 2012; Smith-Lacroix et al, 2012). While lacking mathematical elegance (Merchant, 2008), the risk of ignoring individual perspectives due to excessive reliance on 'remote inferential empirical materials' (Falconer and Mackay, 1999, p. 288) is reduced. A thorough exploratory approach, investigating whistle-blowing at the interface between theory and practical application and immersed in real-world issues is adopted (Power, 2003; McMillan, 2004; Ahrens et al, 2008).

In addition, a preoccupation with positivist research styles dominated by agency theory has led to the marginalisation of alternate perspectives on corporate governance (Chua, 1986; Ahrens and Chapman, 2006; Brennan and Solomon, 2008). This research is mindful of this,

as well as of the lack of corporate governance research from an African perspective, on s45 of the APA specifically and on whistle-blowing by external auditors in general (Section 1.2). Each of these shortcomings highlights clear ‘gaps’ in the existing body of research, reinforcing the argument in favour of a more exploratory or interpretive research strategy. To this end, this research adopts a mainly qualitative approach relying on detailed interviews, complemented to a limited extent by correspondence analysis, to investigate and explore the role of the RI provisions in South African audits.

---

## **3.2: RESEARCH DESIGN**

---

---

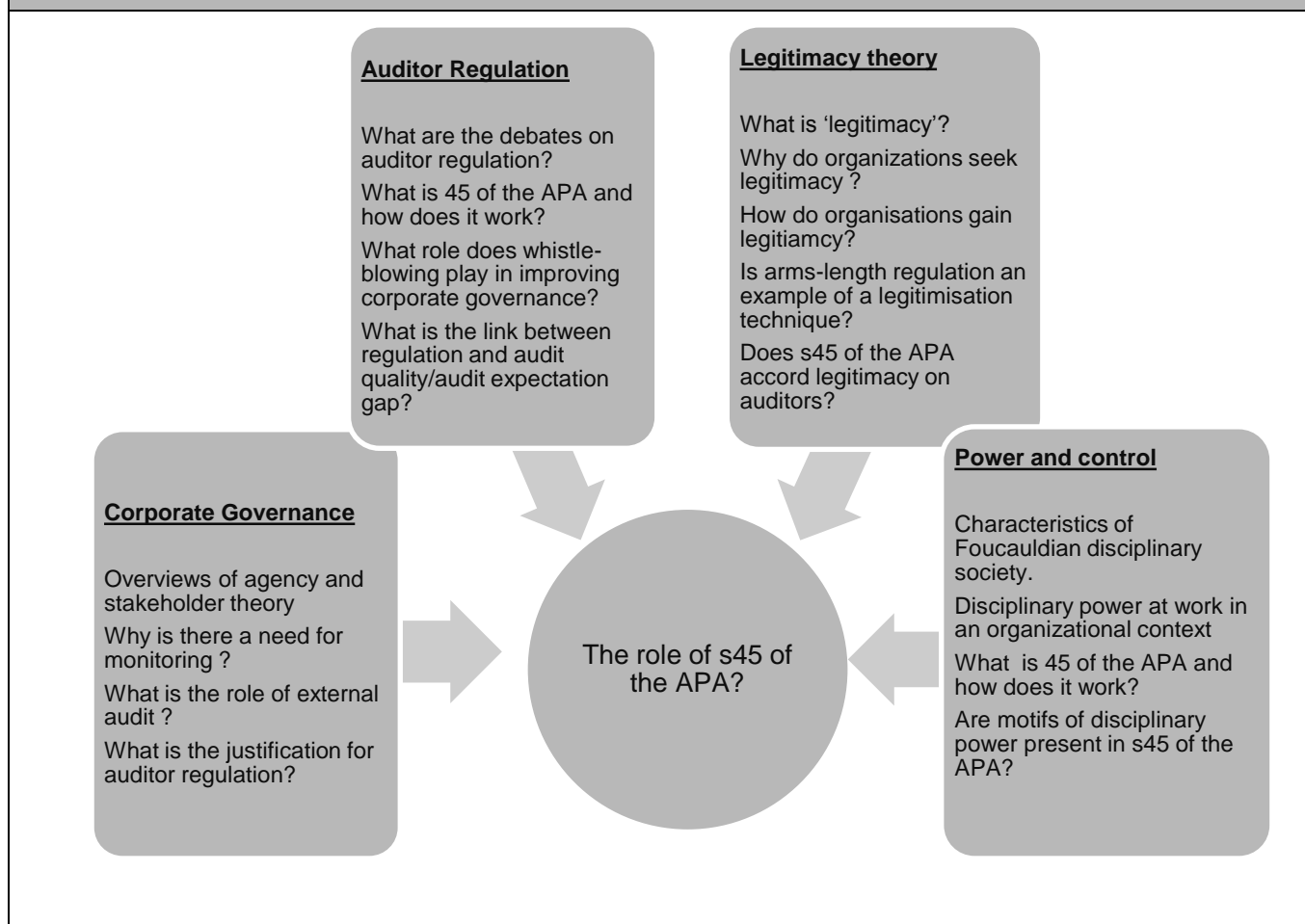
### **3.2.1: DETAILED INTERVIEWS AND LITERATURE REVIEW**

---

#### **Literature Review**

A content analysis of the prior literature is used to identify ‘knowledge gaps’ in the existing research and provide a theoretical framework for the thesis (Leedy and Ormrod, 2001; Creswell, 2009). The following contents or ‘theme categories’ were used to aggregate, classify and interpret previous scholarly works and draw relevant interconnections: firstly, a broad category on corporate governance, agency theory and stakeholder theory. Included in this category is research on the role of external audit, definitions of ‘audit quality’, variables affecting audit quality and audit expectation gap. Second, an auditor regulation category which included details on the operation of s45 of the APA, debates on external and self-regulation and whistle-blowing was added. Third, a category for work on conceptions of ‘legitimacy’, as well as the application of legitimacy theory in different institutional and organisational contexts, was developed. Finally, Foucauldian-inspired research in accounting and management contexts (including certain of Foucault’s work and related commentary) was included in a ‘power and control’ category. This is presented diagrammatically as follows:

**FIGURE 3.1: DIAGRAMMATIC OVERVIEW OF THE CONTENT ANALYSIS**



### **Detailed interviews**

Detailed interviews are a form of idiographic research (Alvesson, 2003; Creswell, 2009) where verbal content is complemented by insights from studying tone, expression and non-verbal responses (Parker and Roffey, 1997; Alvesson, 2003). Participants are able to: give accounts of their experiences; express opinions supported by hypothetical reasoning; furnish explanations on the rationale behind their conclusions; and clarify ambiguities as needed, allowing for the underlying subject matter to be thoroughly described and explained (Holland and Stoner, 1996; Holland and Doran, 1998; Houghton et al, 2011; Smith-Lacroix et al, 2012). In other words, the method ensures that the variables examined, emerging themes and documented accounts capture the perspectives of those involved in the practical application of the RI provisions.

As the emphasis is on exploring detailed accounts of s45 of the APA, interviews are semi-structured to allow the researcher to 'remain open to pursuing emerging trends, themes and

patterns' (O'Dwyer et al, 2011, p. 39) as they arise during the interview process. Unlike a questionnaire, structured interviews, or models using archival data, the chosen method has a greater exploratory potential and is more flexible. It covers a broad range of topics and adapts as and when information emerges (Creswell, 2003; Bryman and Bell, 2007; Creswell, 2009). For interpretive studies, this is especially important as the validity and reliability of findings is ultimately concerned with convincing the reader that the underlying phenomenon has been explored in detail and that the results are effectively trustworthy (Laughlin, 2007; Davila and Oyon, 2008; Creswell, 2009).

With positivist research, sophisticated statistical techniques conducive to reproduction of results constitute validity and reliability checks. This is not, however, conducive to more interpretive studies (Merchant, 2008; Creswell, 2009). Instead, semi-structured interviews allow respondents to 'interpret and describe the phenomenon in their own way' (Holland, 2005, p. 250), providing for an extensive exploration of the subject matter (Creswell, 2009; O'Dwyer et al, 2011) without excessive restrictions imposed by scientific analysis. In other words, using detailed interviews for examining the role of the RI provisions adds to the quality of the findings by overcoming the risk of over-simplifying auditing systems or ignoring the relationship between theory and practice when investigating understudied aspects of corporate governance (Moore, 1991; Parker and Roffey, 1997; Power, 2003; Quattrone and Hopper, 2005; Ahrens et al, 2008). The intention is not to generalise or 'reduce' the problem to find a definitive solution but to illuminate and document multiple perspectives. Detailed interviews, supported by a correspondence analysis, are able to capture the essence of the research problem and incorporate practicality by examining the viewpoints of leading experts and users on the 'front lines' of business developments (consider: Chua, 1986; Laughlin, 1995; Power, 2003; Laughlin, 2007; Ahrens et al, 2008; Dillard, 2008). The result is direct and meaningful 'engagements with practitioners...seeking out their perspectives on their work and its evolution' (O'Dwyer et al, 2011, p. 39) addressing Power's (2003) calls for more field-work-based auditing studies.

Despite its tediousness, complexity of the data analysis process, and risk of researcher bias, validity concerns can be readily managed (Oakes et al, 1998; Creswell, 2009; Rowley, 2012). As such, detailed interviews provide an invaluable primary source of information in emerging areas of study (Holland and Stoner, 1996; Bryman and Bell, 2007; Creswell, 2009; O'Dwyer et al, 2011). For example, Cohen et al (2002) used semi-structured interviews to understand the then little-investigated process of how auditors internalise the relevance of corporate governance when planning and executing an audit. This study uses similar techniques to investigate s45 of the APA and its perceived interrelationship with audit

quality, legitimacy and notions of disciplinary power, a topic which has not been the subject of direct research.

In addition, traditional questionnaires, which depend on adequate coverage to ensure validity, were not expected to be successful due to traditionally low response rates, particularly on the part of audit experts (Rowley, 2012; Appendix B2). Interviews capable of providing detailed accounts from smaller sample sizes are, thus, more appropriate, especially given the complex nature of the subject matter; lack of direct prior research (Section 1.2); and intention of this research to explore critical perspectives on the RI provisions (consider Martens and McEnroe, 1992; Hassink et al, 2010; Georgiou and Jack, 2011; Houghton et al, 2011; O'Dwyer et al, 2011; Rowley, 2012).

To this end, semi-structured interviews are based on the provisions of ISQC 1 and the prior literature on audit quality, legitimacy and power and control theory. To ensure clarity and structure, interview agendas are largely aligned with the research sub-questions. Two interview agendas are used (Appendix B4). The first is for audit experts and, therefore, questions on audit quality and quality control systems are more technical. The second agenda is for informed users and, although similar to the first agenda, has a less technical focus on audit quality/quality control systems. This is due to the fact that the opaqueness of the audit process may have prevented users being privy to the same detailed information on the audit process as experts (Power, 1994; Power, 2003; FRC, 2010; KPMG, 2010; PwC, 2010). Both agendas have been subject to peer review to ensure clarity, accuracy and appropriateness (ability to address the research objectives) by supervisors, the technical consultant and University of the Witwatersrand School of Accountancy's Audit and Management Accounting Divisions. The interview agendas were also piloted (Appendix B3), as recommended by Brennan and Kelly (2007) and Leedy and Omrod (2001), with no material issues noted<sup>36</sup>.

---

<sup>36</sup> Peer review, especially by the technical consultant, is an important quality check serving to ensure that the study does not resonate only with the researcher (Creswell, 2009).



---

### 3.2.2: CORRESPONDENCE ANALYSIS<sup>37</sup>

---

Interpretive research using detailed interviews runs the risk of becoming cumbersome (Merchant, 2008). This is especially so when the content is highly subject-specific. In such cases, quantitative methods can be used to aggregate findings, simplify the report and improve validity (Parker and Roffey, 1997)<sup>38</sup>. Consequently, a correspondence analysis is used to summarise the perceptions of experts on the perceived effect of s45 of the APA on audit quality due to the relatively technical nature of this part of the research (Chapter 5). The final correspondence plot (Figure 5.1) was also discussed with respondents during follow-up sessions to ensure a thorough analysis of the plot and afford participants an opportunity to take stock of and respond to the emerging collective ‘view’ on the role of the RI provisions in South African audits<sup>39</sup>. The intention was not to ‘quantify’ or ‘verify’ results, but to provide an easy-to-interpret two-dimensional plot (Bendixen, 1996; Maroun et al, 2011) that reduces the complexity of ISQC 1; summarises key arguments and counterarguments on the association between the RI provisions and conceptions of audit quality; and facilitates additional discussion with interviewees.

Rather than rely on a scientific approach for developing the survey questionnaire (correspondence table), a less rigid social constructivist technique similar to that described by Solomon and Maroun (2012) and Merkl-Davies et al (2011) is used. As discussed in Section 2.2.4, quality elements derived from ISQC 1 – and informed by the prior literature and local codes of governance – serve as row headings or statements in the Table 3.1 below. Key subsections of the RI provisions (Section 2.1.3) serve as column headings. The researcher constitutes the ‘measurement instrument’, allowing for the ‘essence’ of ISQC 1 to be included in the correspondence table (see also Merkl-Davies et al, 2011; Solomon and Maroun, 2012). Although this poses some threat to validity due to inherent subjectivity (Creswell, 2009), the approach is more conducive to smaller sample sizes in an exploratory setting where, paradoxically, a more scientific approach could be a hindrance. Further, the interpretive derivation of the correspondence table ensures that the correspondence results

---

<sup>37</sup> Special thanks go to the commentators at the Southern African Accounting Association (SAAA) Conference (2011) and the British Accounting and Finance Association Conference (2012), as well as the anonymous reviewers from the International Journal of Accounting, Auditing and Taxation for their feedback regarding the correspondence analysis (Appendix G).

<sup>38</sup> Although the correspondence analysis relies on principal component analysis to ‘reduce’ data (Section 3.4.2), the method remains largely interpretive, given the design of Table 3.1 and complementary role of the correspondence plot when carrying out follow-up interviews.

<sup>39</sup> For this purpose the design and means of interpretation of the plot was explained to respondents, as discussed in this section and Section 3.4.

are easily incorporated in discussion with interviewees (Coldwell, 2012; Maroun, 2012b; Weetman, 2012).

The final result is a 7 column x 12 row correspondence table (Table 3.1). Each row is labelled 'R1' to 'R9'. Columns are labelled 'C1' to 'C7'<sup>40</sup>. Respondents were required to mark with an 'X' cells where quality characteristics (rows) correspond – in their opinions – with the respective column headings (the RI provisions). Accordingly, each cell could have been marked with an 'X' or left blank equivalent to a response in the affirmative or negative respectively. Each 'X' was assigned a value of one. Non-responses were assigned a value of zero. Results were aggregated manually into a single frequency table and reduced to a two-dimensional plot using correspondence analysis (principal component analysis) courtesy STATA.

A similar approach has been used in a marketing setting by Lee and Bradlow (2011), exploring product attribute relevance in the eyes of consumers. Correspondence analysis is employed to assign features of chosen products to particular 'attribute dimensions'<sup>41</sup>. Principal component analysis reduces the findings to a graphical representation based on product reviews completed by a sample of customers that allows for easy 'visualisation' of the results. Correspondence analysis has also proved useful in studying the association between non-financial indicators and managerial performance, effectively 'grouping' responses from a questionnaire on the association between non-financial performance metrics and three fields of organisational activity, to facilitate easier analysis (Gaber and Stoica, 2012). In a similar study, Chan et al (2002) use a form of correspondence to examine how different training modules are perceived to impact a selection of work activities in a manufacturing case study. Finally, Maroun et al (2011) use correspondence analysis to identify themes in the tax literature and highlight associations between 'tax fairness' attributes and Capital Gains Tax. Consistent with Merkl-Davies et al (2011), the 'tax fairness matrix' is driven by interpretive text analysis, similar to that followed in this research. The correspondence table used in Chapter 5 is presented below.<sup>42</sup>

---

<sup>40</sup> The order of entries in the correspondence table and assigned symbols has no specific meaning.

<sup>41</sup> The result is a brand-attribute matrix similar in substance to Table 3.1, albeit that the researchers chose a scientific approach relying on text mining to identify brands and attributes.

<sup>42</sup> In keeping with an interpretive style, measures of internal consistency such as Cronbach Alpha are not required. This is also justified by the fact that respondents either endorse a cell or not, meaning that the data scale is ordinal. It should be stressed that the correspondence plot simply serves as an easy-to-interpret summary of the perceived correspondence between the RI provisions (columns) and audit quality elements (rows). The intention is not to quantify or statistically verify notions of audit quality.

TABLE 3.1: CORRESPONDENCE TABLE								
	Quality Trait <sup>43</sup>	Provisions of s45 of the Auditing Profession Act						
		RI's are to be reported to the IRBA	Reporting to take place immediately vs. after 30 days under the PAAA	Failure to report an RI could lead to liability and criminal sanction	Wrongful reporting could lead to a claim for damages	RI's include fraud, irrespective of materiality level	RI's include a material breach of trust and fiduciary duty	RI's involve management only
		C1	C2	C3	C4	C5	C6	C7
R1	Development of a culture of leadership with more participation by the engagement leader (para 9)							
R2	Awareness of the importance of ethical compliance (para 14 & 18) including client acceptance and continuance procedures (para 28)							
R3	Acknowledging the importance of resources & competency of engagement team (para 36) as well as the need for full compliance with ISA (para 46)							
R4	Ensuring appropriate consultation on contentious matters and resolution of differences of opinion (para 51)							

<sup>43</sup> Paragraphs refer to the provisions of ISQC 1.

TABLE 3.1: CORRESPONDENCE TABLE								
	Quality Trait <sup>43</sup>	Provisions of s45 of the Auditing Profession Act						
		RI's are to be reported to the IRBA	Reporting to take place immediately vs. after 30 days under the PAAA	Failure to report an RI could lead to liability and criminal sanction	Wrongful reporting could lead to a claim for damages	RI's include fraud, irrespective of materiality level	RI's include a material breach of trust and fiduciary duty	RI's involve management only
		C1	C2	C3	C4	C5	C6	C7
R5	More attention paid to internal quality control and continuous improvement processes including documentation standards (para 74)							
R6	Enhanced transparency and confidence in the audit process and increased perceived value for stakeholders (including improved reporting quality)							
R7	Enhanced sustainability for audit firms including reduction in overall audit risk							
R8	A sense of legitimacy in the eyes of the informed public							
R9	A sense of personal responsibility for auditors and auditors being held to account							

As the correspondence table relies on a thorough technical understanding of s45 of the APA and provisions of ISQC 1, it is completed only by experts<sup>44</sup>. The correspondence analysis was carried out immediately after the first round of detailed interviews. Data is, therefore, cross-sectional and will not capture changing perceptions over time. While this does detract from the exploratory potential of the data, it allows the research to focus on the specific time period under review. This means that the long term variables, such as changing cultures or political climates, are held constant. Prior to administration of the correspondence analysis, the Table 3.1 was reviewed by the technical consultant and University of the Witwatersrand School of Accountancy's Audit and Management Accounting Divisions. The correspondence table was then piloted (Appendix B1) with no material issues noted (Appendix B1)<sup>45</sup>.

---

### 3.3: SELECTING PARTICIPANTS<sup>46</sup>

---

---

#### 3.3.1: POPULATION

---

The population of experts consists of all Registered Accountants and Auditors (RAA) in South Africa. The population of users is less easily determined as multiple stakeholder groups may have an interest in audit for different reasons. For the purpose of this thesis, the population of informed users is taken to mean directors of companies, including audit committee members, listed on the JSE, relevant regulatory bodies and institutional investors. All users have at least ten years of audit-associated experience by virtue of either past service as an auditor; direct engagement with auditors in their current capacity or a combination of both (Section 1.3).

---

<sup>44</sup> This is not to say that users are not well informed of the audit process. As discussed in Section 3.3, they represent some of the leading auditing and corporate governance minds in South Africa. These users were not, however, practicing auditors and would not, therefore, have been able to provide current detailed insight on the *application* of the RI provisions on specific audit engagements.

<sup>45</sup> The research confirmed the appropriateness of the correspondence analysis – as opposed to a traditional questionnaire – as part of the pilot study (Appendix B2).

<sup>46</sup> 'Sample' and 'population' are not intended to imply a positivist research approach.

---

### 3.3.2: SAMPLE SELECTION

---

#### **Audit experts**

Experts were selected using a purposeful selection technique mindful of ease of access. Firstly, all Big Four firms, the three largest second-tier audit firms, the IRBA, SAICA and South Africa's top three universities were selected<sup>47</sup> (adapted from Creswell, 2009). Each selected organisation is regarded as reputable as it is among the largest audit firms in South Africa (DeAngelo, 1981a; DeAngelo, 1981b), a registered member with the IRBA in good standing (IRBA, 2011), or a top-ranking South African university<sup>48</sup>. Participation by individuals at each of the selected organisations was driven solely by ease of access.

Due to the limited number of experts dealing with s45 of the APA, as well as large volumes of data collected during interviews, the number of interviews was limited (Bendixen, 1996; Holland, 1998a; Rowley, 2012). Sixty-eight experts were approached. Seventeen were interviewed and completed the correspondence analysis. A further forty seven could not be interviewed but did complete the correspondence table after being given instructions on how to do so and background on the nature and purpose of the research, as discussed below. A listing of interviewees may be found in Appendix F. Detailed interviews (and the correspondence analysis) were carried out in Cape Town, Johannesburg and Pretoria, South Africa, between 1 May 2011 and 1 October 2012 and lasted between one and three hours. All initial interviews were recorded electronically except four which were recorded manually<sup>49</sup>.

This research is specifically focused on 'gaining the perspectives of practitioners who had been directly involved in shaping assurance practice' (O'Dwyer et al, 2011, p. 38) in South Africa. Although purposeful selection of experts may result in a degree of bias, it ensures that only knowledgeable participants were engaged in the research, given its technical nature (Creswell, 2009; Rowley, 2012). A comparable approach is employed by Brivot and Gendron (2011) and Cohen et al (2002) who purposefully select participants at specific levels within firms to ensure a focused and meaningful analysis. Similarly, Kaplan and

---

<sup>47</sup> Participants are drawn from the Big 4 and smaller firms. This ensures that different organisational contexts or cultures are captured by the interviews, adding to the depth of information gathered. The purpose of the research is **not**, however, to contrast the views of large and small audit practices with an aim to adding to the debate on whether or not the Big 4 provide higher quality audits than their smaller counterparts (Chapter 8).

<sup>48</sup> Per the QS World University Rankings (2012)

<sup>49</sup> The data collection and analysis process described in Section 3.4.1 applied *mutatis mutandis* to manually recorded interviews.

Schultz (2007) purposefully select participants with more practical experience to improve result quality for a study into whistle-blowing, while Creswell (2009) recommends selecting individuals who have a thorough understanding of subject matter to ensure research quality in qualitative studies. Ultimately, participants were selected based on their skill and experience for the purpose of explaining the role played by s45 of the APA in South African audits and not for 'quantifying' results using larger samples in a positivist style.

As per Section 1.3, all experts are individuals with several years of practical or academic experience and extensive knowledge of ISQC 1 and the RI provisions, as well the audit environment and culture. Although some, for example Power (1995), argue that years of service may not be correlated with levels of expertise, and that this poses problems for generic auditor judgement research, due to the fact that this research studies a narrowly defined aspect of South African audits, this not regarded as a material issue.

### **Informed users**

Detailed interviews were also conducted with informed users to complement the insights provided by audit experts<sup>50</sup>. Informed users were selected from among the ranks of the boards of directors of companies listed on the JSE, various regulatory and government bodies in South Africa, as well as institutional or professional investors. Ease of access and availability were the primary participation-determinants.

All users are knowledgeable of the audit process and have several years of experience in a financial and governance setting. Most respondents were members of audit committees or representatives of government/regulatory bodies constituting some of the country's most influential minds in the area of auditing and corporate governance. Thirty three individuals were approached. Thirteen participated in the research (Appendix F). All interviews were held between 1 May 2011 and 1 October 2012 in Johannesburg, Cape Town, Pretoria and Durban and lasted between one and two hours. All initial interviews were recorded electronically.

---

<sup>50</sup> As discussed in Section 1.4.2, the aim of this research is **not** to contrast the views of experts and users with an aim to examining the audit expectation gap. Due to users' having a high level of technical expertise (as well as relatively small sample sizes in light of the interpretive structure of this thesis), a more detailed evaluation of audit expectation gap in the context of the RI provisions is deferred for future research (Chapter 8).

## **Summary**

Although concerned with the opinions of respondents, rather than scientifically validated 'fact', choosing well-informed participants becomes its own form of validity and reliability check, (Humphrey, 2008; O'Dwyer et al, 2011; Coldwell, 2012). In addition, by interviewing some of the country's leading audit and governance experts, complemented by follow-up sessions and a correspondence analysis as appropriate, key themes or concepts were readily identified. In turn, these were contrasted with the comments of other respondents and with the perspectives found in the prior academic and professional literature to ensure high research quality (Holland, 2005).

---

### **3.3.3: SAMPLE SIZE AND ACCESS**

---

Smaller sample sizes are common for qualitative studies (Leedy and Ormrod, 2001; Creswell, 2009). For example, Cohen et al (2002), research the impact of clients' corporate governance systems on auditors' risk assessment processes, using detailed interviews as a data collection instrument. Due to time constraints and the volume of data generated, a total of thirty three interviews were conducted. Likewise McCann et al (2003), in a study on socially responsible investment strategies, rely on twenty three interviews with well-informed investment specialists. Similarly, Holland (1998a) makes use of thirty three participants while Uddin and Choudhury (2008), Holland and Doran (1998) and Holland and Stoner (1996) use under thirty participants for their respective qualitative studies. In each of these cases, the intention is not ensuring statistical coverage but allowing for manageable data collection while still being able to gain detailed insights. By analogy, a total of thirty interviews averaging 90 minutes in duration are carried out. There were no withdrawals during the course of the study. For ease of reference, this thesis uses U1-13 and E1-16 to identify the user and expert interviewees respectively. (The objective of this thesis is not, however, to contrast explicitly the views of experts and users as discussed in Section 1.4.2.)



## 3.4: DATA COLLECTION AND ANALYSIS

---

### 3.4.1: DETAILED INTERVIEWS

---

Participants were contacted via telephone or e-mail and invited to participate in the study after being given a brief description of the purpose of the research. A time was set for the interview and completion of the correspondence table (Table 3.1). A subsequent e-mail confirmed the meeting times. Following a similar approach to O'Dwyer et al (2011), Cohen et al (2002), Holland and Doran (1998) and Holland and Stoner (1996), an agenda containing open-ended questions (Appendix B4) was e-mailed to participants at least three working days before the interview to allow participants sufficient time to consider their responses and ensure detailed accurate accounts. To address the risk of response rehearsal, the agendas were deliberately brief. The date, time, location, duration of meeting and attendees were recorded for each interview. Interviews were conducted at the location of choice of the interviewee to encourage complete candour and participation.

At the start of the interviews, participants were briefly reminded of the nature and purpose of the research; given the researcher's details; and provided with additional information as requested. Time was spent establishing rapport with each interviewee to ensure participants' confidence (Creswell, 2009; O'Dwyer et al, 2011; Rowley, 2012). The background to the research was discussed, as well as general industry developments. Participants were informed that research was being carried out independently and was for academic purposes only. They were reassured that there are no 'correct' responses and that the purpose of the research was simply to explore their own perceptions and experiences. They were encouraged to talk freely and reminded of guaranteed confidentiality, their right to withdraw from the study at any point and that each would receive a copy of the final report (adapted from Oakes et al, 1998; McCann et al, 2003; Brivot and Gendron, 2011; O'Dwyer et al, 2011). Finally, a consent form was completed at the start of the interview (Appendix E). These steps were designed to reduce the risk of respondents withholding commentary or feeling compelled to provide responses perceived as being socially or politically appropriate rather than personal, unedited views (Alvesson, 2003).

More specific agenda points were used to structure the interview (Appendix B4) although the interview process remained semi-structured in that unexpected questions or issues raised by participants were explored as and when they arose. This allowed for more detailed accounts on the role of the RI provisions in South African audits than if, for example, a questionnaire

was used. The extent to, and sequence in which, issues were addressed by respondents varied but the same issue, the operation of s45 of the APA, was dealt with at the start of each interview. (adapted from Holland, 1998a; Holland, 1998b; O'Dwyer et al, 2011).

As with most qualitative studies, the data collection and analysis process took place concurrently (Leedy and Ormrod, 2001; Creswell, 2009). As far as possible, the researcher refrained from interrupting or pre-empting the participant, leaving it to the interviewees to raise the majority of the issues and to go into detail on specific themes or concerns. Questions posed were, to the extent possible, neutral and non-leading. At the same time, respondents were, on occasion, asked to explain a particular concept or statement in different words or from different perspectives to address 'script coherent expressions' or resolve any ambiguities (Alvesson, 2003). As an additional validity safeguard, each interview was conducted individually to prevent dominant participants influencing the decisions of others and avoid the risk of a loss of anonymity affecting results.

As most interviews were electronically recorded, the need to stop the interview to allow for note taking; the risk of incomplete data capture; and the risk of transcription error were reduced. The full attention of the researcher could also be devoted to the interviewee, adding to the quality of the results. Where recording was not permitted, the researcher used a touch pad to minute the meetings. In these instances, notes were made frequently to avoid the researcher unintentionally signalling participants (Alvesson, 2003). All transcripts were assigned a unique code to ensure completeness and confidentiality. Electronic recordings were transcribed and additional embedded comments added as soon as possible after the interview was completed. This included notes on areas for probing either in follow up sessions (see below) or other interviews (as per O'Dwyer et al, 2011).

Data analysis was by means of a 'data analysis spiral' (Leedy and Ormrod, 2001; Rowley, 2012). Firstly, recorded interviews were perused. Preliminary conceptualising and cataloguing was facilitated by informal note taking. The aim was to obtain a sense of the essence of each recording (Leedy and Ormrod, 2001, p. 153) which, as per Creswell (2009), Davilla and Wouters (2005) and Parker and Roffey (1997), was read several times. Initial notes on recordings were contrasted and general themes, categories and interconnections were identified. A 'data mind map' was used for this purpose (adapted from Oakes et al, 1998; Holland, 1998a; Holland, 1998b; Leedy and Ormrod, 2001). Content was organised initially under headings and sub-headings consistent with those used in the literature content analysis (Section 3.2).

Closer scrutiny of field notes and the prior literature led to reclassification of interview content and research sub-codes as necessary. Final categories (axial codes) are summarised in Table 3.2.

<b>TABLE 3.2: AXIAL CODES USED FOR DATA ANALYSIS</b>		
<b>#</b>	<b>Content category</b>	<b>Description</b>
C-1	Importance of ethical values and leadership principles	For example, content on the impact of s45 of the APA on ethics training and awareness; client acceptance and continuance; and engagement leader participation fell under this category.
C-2	Human resource practices and engagement performance	Commentary on engagement execution; constitution of audit teams; client acceptance and continuance and monitoring; and consultation and supervision are examples of content aggregated under this category.
C-3	Continuous improvement	Commentary on continuous improvement; perceived impact of s45 of the APA on audit quality in general; extent of reliance on audit reports; recommended developments for whistle-blowing regulation were included here.
C-4	Legitimacy and credibility	Notes on the meaning and relevance of legitimacy, including how auditors seek legitimacy, were documented under this category. Comments from informed users and experts on how and why s45 of the APA adds to the legitimacy of and trust vested in the audit process were included under this category, including any counterarguments or alternate views. This category also included commentary on expectation gaps, unintended consequences of the legislation, and governance of audit firms in general.
C-5	Disciplinary power.	The final category included literature and commentary from experts and informed users on notions of disciplinary power. Conceptions of the 'principles of enclosure', 'efficient bodies' and 'surveillance' (Foucault, 1977) inherent in s45 of the APA were included under this category, as well as how notions of power and control could impact on perceived audit quality and legitimacy.

Defining content categories (axial codes) using the provisions of ISQC 1, the prior literature and the research sub-questions (Section 1.4) is important for providing structure and ensuring that each sub-question is addressed. In effect, it allows the research process to be easily traced to the primary phenomenon under investigation (adapted from Parker and Roffey, 1997; Creswell, 2009; O'Dwyer et al, 2011; Rowley, 2012). It also counters the risk of bias imported by the researcher imposing arbitrary or subjective categories. Further, using predetermined axial codes did not detract from the iterative and exploratory nature of the research. Specific themes or concepts emerging during the course of the interview and analysis process drove the development of sub-categories or open codes. Notes on the different phrases or comments were made on each transcript and used to summarise the significant points from each interview. Initially, notes were manually aggregated according to their similarities and interconnections, effectively coding them. All notes were numbered and cross referenced to a 'code register' or 'legend' to allow for easy data analysis. Codes with few or no allocations were aggregated. The product was a 'summary table' (O'Dwyer et al, 2011) for each transcript which effectively 'assigned' the transcript content to different content 'pools' each of which is aggregated under the broad axial codes above (adapted from Parker and Roffey, 1997; Leedy and Ormrod, 2001; Creswell, 2009; O'Dwyer et al, 2011). Transcripts were read several times for the purpose of coding until a sense of saturation was achieved (O'Dwyer et al, 2011).

After the completion of the initial data analysis, follow-up questions were raised as needed. In this way, the research may be seen as a *quasi* policy-style-Delphi-study where additional questions are posed to participants to clarify emerging themes, elaborate on key arguments and counterarguments, and clarify any ambiguities. Conceptually, this is similar to a traditional Delphi where statistical patterns or anomalies are explored in greater detail, albeit that this study adopts a qualitative approach and does not seek a measure of statistical consensus (Novakowski and Wellar, 2008). Instead, the result was a highly flexible and dynamic data collection process with interviews, data transcription, coding, analysis and updating of results occurring almost continuously (Leedy and Ormrod, 2001; Creswell, 2009). Grounding the interviews in the prior literature, execution of multiple interviews, and the use of follow-up sessions allowed for a form of result 'triangulation'<sup>51</sup> which contributed materially to the thoroughness of the findings and the reliability of any conclusions reached (Leedy and Ormrod, 2001; Alvesson, 2003; Creswell, 2009). (For Chapter 5, in particular,

---

<sup>51</sup> In this context, 'triangulation' does not imply the existence of a unique objective reality. Rather, it refers to using multiple data sources to achieve a detailed exploration of the phenomenon under review ensuring the identification of interconnections, biases and emerging themes (Leedy and Ormrod, 2001; Creswell, 2009).

the correspondence analysis, by aggregating perceptions, also provided an internal consistency check.)

Follow-up questions were posed either telephonically, by e-mail or during additional interviews depending on ease of access, time restrictions of the participants, and budgetary limitations. These questions were derived from initial analysis of the interview transcripts as well as the findings from the correspondence analysis<sup>52</sup>. Data collection and analysis continued to a point where a sense of saturation, rather than a measure of consensus, was achieved (Alvesson, 2003; Novakowski and Wellar, 2008). Consequently, only a limited number of follow-up sessions were held and not all participants were equally engaged in this process. This is an inherent characteristic of the chosen research methodology and not necessarily a threat to validity and reliability (Quattrone and Hopper, 2005; Creswell, 2009). Rather, this approach is inspired by a 'reflexive pragmatism' in the sense that, while different perspectives are explored, practically, 'endless reflexivity' needs to be balanced in the name of 'direction and accomplishment' (Alvesson, 2003, p. 14).

Results were transcribed as described previously. Where necessary, additional interview material was reviewed several times and contrasted with original results from follow-up sessions, effectively complementing the already coded data or being used to revise the coding accordingly. At this stage, the findings from the prior literature and theoretical perspectives adopted for the purpose of this research (Chapter 2) were considered to add to the thoroughness of the analysis (Oakes et al, 1998; Ventovuori et al, 2007; Ahrens et al, 2008; O'Dwyer et al, 2011).

In summary audit research in the positivist tradition, although seemingly valid, 'is very often studying correlations between independent (market variables) and proxy measures for a dependent audit variable (such as audit quality) or focusing on a fabricated form of audit practice that has been generated through a series of audit experiments' (Humphrey, 2008, p. 179). In contrast, detailed interviews provide an extensive account of perceptions and experiences. By thoroughly documenting results in a fashion that is easy to understand, the nature and limitations of the research findings can be readily assessed by the reader, itself a form of validity safeguard (Creswell, 2009; IASB, 2010). Where dealing with highly technical content (Chapter 4), the correspondence analysis, discussed below, then ensures clarity by condensing results into an easily interpreted two-dimensional plot. This combines the

---

<sup>52</sup> The correspondence plot (Figure 5.1) was discussed with several respondents during follow-up sessions to add depth to the interview findings. For this purpose, the design and interpretation of the correspondence analysis, as per this chapter, was explained to interviewees. At no time did the interviewees indicate that the correspondence table or final plot was unclear or difficult to interpret. Questions posed were largely in line with those found in Table 3.1 and Appendix B4 and concentrated on analysing the reason for correlations between row and column headings (Section 3.4.2).

benefits of detailed descriptions from the detailed interviews, with the simplified overview of results provided by an easy-to-understand quantitative technique (Bendixen, 1996). The end result is simple, clear communication (Merchant, 2008; Creswell, 2009) and articulation ideas, opinions, judgements and values (Baxter et al, 2008; Brennan and Solomon, 2008; Cooper, 2008; Scapens, 2008; Willmott, 2008; O'Dwyer et al, 2011).

---

### 3.4.2: CORRESPONDENCE ANALYSIS

---

Upon completion of the detailed interviews, experts were required to complete a correspondence table (Table 3.1). This ensured that the nature and purpose of the research was fresh in the experts' minds while respecting their time constraints. In instances where experts were not available to be interviewed (Section 3.3.2), the nature and purpose of the research was explained in detail to provide respondents with the context of the study. In both cases, the design of the correspondence table, per Section 3.2.2, was explained and brief instructions on how to complete the table were provided<sup>53</sup>. Before completing the correspondence table, experts were reminded of the need for complete candour and of guaranteed anonymity, after which they were left to complete the table in private<sup>54</sup>. Experts marked those cells where row and column headings were regarded as corresponding, with the result that the correspondence table was akin to a standard survey instrument that recorded the responses of experts on the perceived *association* between the RI provisions and audit quality elements (Section 2.2.4).

To ensure that the correspondence table was free from technical errors or ambiguities, the survey was piloted (Creswell, 2009) with no material issues noted (Appendix B1). All correspondence tables were assigned a unique number to ensure confidentiality and completeness and accuracy of final results. As a final quality check, the choice and use of the correspondence analysis was reviewed by an independent statistician who confirmed the appropriateness of the chosen method and its application.

---

<sup>53</sup> The following example was provided to respondents: *if you feel that the fact that RI's are reportable to the IRBA (C1) results in you being more active on the engagement and encourages a culture of leadership (R1), then place an 'X' in the cell. If you feel that this is not the case, then leave the cell blank. The remainder of the table is completed in the same fashion. You may place as many 'X's' as you feel appropriate.* After being given this explanation, respondents were left to complete the correspondence table without further intervention by the researcher.

<sup>54</sup> The same approach was used with experts who were unavailable for interview (Section 3.3.2). These individuals were provided with a summary of the nature and purpose of the research as explained in Section 3.4.1.

Responses were manually aggregated and included in a final summary table. Briefly, the response rate for each of the rows (i.e. the degree of correspondence with the column headings) is translated into a row and column ‘mass’ which is used to interpret or define the axes of a two-dimensional space and the positioning of different point-row plots (Table 3.6; Table 3.7). The final 7 column x 9 row correspondence plot is presented in Figure 5.1 (Section 5.1). Table 3.3 summarises the descriptive statistics. Most notably the first (x-axis) and second (y-axis) dimension of the plot account for just over 81% of the total inertia (or 81% to the total Chi-square score of 113) and, thus, for most of the exploratory potential of the graphical plot. The Chi-square value of 113.09 is also well in excess of the minimum critical value of approximately 67.5 at the 5% significance level (Appendix C).

<b>TABLE 3.3: DESCRIPTIVE STATISTICS FOR CORRESPONDENCE ANALYSIS</b>	
Active rows	9
Active columns	7
Number of observations <sup>55</sup>	1203
Pearson $\chi^2(48)$	113.09
Prob > $\chi^2$	0
Total inertia	0.094
Number of dim.	2
Expl. inertia (%)	81.13

As discussed above, the row and column profiles and masses were used to calculate the inertia (variance) that each cell accounted for in the contingency table. A point-row and column plot may be found in Appendix C and was developed using principal component analysis as per Bendixen (1996) and adapted from Maroun et al (2011)<sup>56</sup>. The bi-plot (including Table 3.6 and Table 3.7) was used to define the respective axes of the final plot as illustrated in Table 3.4 and Figure 5.1 (Section 5.1).

<sup>55</sup> This is the total number of ‘X’s marked by the 64 experts who completed the correspondence table.

<sup>56</sup> The application of correspondence analysis was tested in a similar interpretive setting thereby adding to the quality of the analysis presented here. Special thanks must go to the anonymous reviewers and to the attendees of the SAAA Conference (2011) and Africa Leads Conference (2012) (Appendix G).

TABLE 3.4: LABELLING OF THE AXES	
Axis	Label
Positive x-axis (axis 1)	C3: Failure to report an RI could lead to liability and criminal sanction
Negative x-axis (axis 1)	C7: RI's involve management only
Positive y-axis (axis 2)	C2: Reporting to take place immediately vs. after 30 days under the PAAA
Negative y-axis (axis 2)	C3: Failure to report an RI could lead to liability and criminal sanction C6: RI's include a material breach of trust and fiduciary duty

As discussed in Section 3.2.2, the respective axes are based on the 'elements' (column headings in Table 3.1) of the RI provisions according to the inertial contribution made by each column heading, its correlation coefficient with the respective axis and its co-ordinate (sign). Only those column headings with an above-average inertial contribution are included for ease of analysis (Bendixen, 1996). In this respect, C1, C4 and C5 had low levels of inertia and/or only weak correlations with either the x- or y-axis and were thus excluded. The positioning of row headings (quality traits in terms of ISQC 1), is determined in a similar fashion. R2, R4, R5, R7 and R9 each makes above average inertial contributions compared to that which would arise given a purely random distribution of statements over the axes. Taking into account the sign of each row-heading coordinate, as well as the respective correlation coefficients and inertial loads, allows each point to be plotted along the x- and y-axes. In this graphical representation, the further a given point is away from the origin (the higher its correlation coefficient and Chi-square value-variance), the greater the association with the respective element of the RI provisions (column heading or axis label)<sup>57</sup> (Adapted from Bendixen, 1996; Maroun et al, 2011). Appendix C provides additional details.

Consistent with the approach followed by Lee and Bradlow (2011), Maroun et al (2011) and Chan et al (2002), correspondence analysis is used to focus on key relationships in an otherwise complex set of interconnected variables or traits (Bendixen, 1996) allowing the researcher to concentrate on the core aspects of the analysis. Aggregated responses are summarised in Figure 5.1 to allow further analysis of only the most relevant associations between the RI provisions and audit quality control elements (consider also Humphrey, 2008; Creswell, 2009). To this end, additional statistical analysis (as done by Lee and Bradlow, 2011) is not used to interpret the final correspondence plot. Instead, an interpretive

<sup>57</sup> This influence is measured by reference to inertial contribution. The sum of the contributions gives an indication of the quality of the plotted point (row heading) but does not prove causation. A point's sign is only indicative of its positioning relative to different elements of the RI provisions (axes) and does not, in itself, imply a favourable or unfavourable association.



approach is employed where the researcher plays an integral role in drawing connections between the correspondence plot and prior literature on auditing. The correspondence plot (Figure 5.1) was also used to inform further discussion on the role of the RI provisions in South African audits during follow-up interviews as discussed in Section 3.4.1. For this purpose Figure 5.1 was made available during follow-up sessions and, after providing a brief overview of the correspondence analysis technique, discussed with interviewees. Questions dealt with the interpretation of associations between row and column points in Figure 5.1. Findings were transcribed and analysed using the same procedure as described in Section 3.4.1.

At this point, it should be noted that each correspondence statement per Table 3.1 could have been structured to yield a traditional questionnaire with a five-point likert scale. This approach was not followed as the questionnaire would have given the impression that the research was attempting to ‘measure’ the extent to which the RI provisions impact audit quality. Any added validity would have been superficial due to smaller sample sizes and inherent subjectivity (consider Humphrey, 2008; Creswell, 2009)<sup>58</sup>. Finally, the results from the questionnaire would not have been as conducive to detailed discussion with a sample of experts, especially since respondents are not statisticians. A key advantage of the correspondence analysis is that it clearly summarises the views of relatively small samples of experts to facilitate additional exploratory analysis without participants having to interpret excessively complex statistical results.

In summary, the aim of the correspondence analysis is not to ‘quantify’ the association between the RI provisions and ISQC 1 quality elements or to ‘prove’ that the provisions drive audit quality. Rather, the bi-plot is used simply to aggregate the perceptions of experts to serve a complementary role in Chapter 5 when exploring the detailed case for the RI provisions. Although the correspondence analysis is a quantitative technique, it is, therefore, still in line with the overall interpretive style of this thesis. A summary of the row statements and where each is discussed in more detail is provided in Table 3.5 below.

---

<sup>58</sup> Questionnaires also have the disadvantage of low response rates. While piloting the correspondence analysis, the researchers asked participants if they preferred completing the correspondence table or a questionnaire based on each of the statements included in the correspondence table. The vast majority commented that the former was easier and quicker to complete and generated a graphical plot that was easier to understand than more traditional quantitative results (Appendix B2).

TABLE 3.5: CORRESPONDENCE TABLE MATRIX			
No.	Row statement (including references to ISQC 1 where applicable)	Related research question	Corresponding discussion
R1	Development of a culture of leadership with more participation by the engagement leader (para 9)	A1: Do the provisions of s45 of the APA cause engagement leaders to take a greater leadership responsibility role on external audits?	Section 4.1; Chapter 5
R2	Awareness of the importance of ethical compliance (para 14 & 18) including client acceptance and continuance procedures (para 28)	A2: What implications have s45 of the APA had on the perceived relevance and importance of adherence to ethical principles on external audits?  A3: Does s45 of the APA lead to a more robust client acceptance and continuance review process and how does this relate to the need for risk management by audit firms?	Section 4.2; Chapter 5
R3	Acknowledging the importance of resources & competency of engagement team (para 36) as well as the need for full compliance with ISA (para 46)	A4: What are the implications of s45 of the APA on the perceived importance of human resource practices?  See also A5 below	Section 4.3; Chapter 5
R4	Ensuring appropriate consultation on contentious matters and resolution of differences of opinion (para 51)	A5: To what extent has s45 of the APA impacted on the performance of external audits including supervision, consultation and review in connection with these audits?	Section 4.3; Chapter 5
R5	More attention paid to internal quality control and continuous improvement processes including documentation standards (para 74)	A6: Has s45 of the APA led to a more comprehensive continuous improvement and monitoring process at the audit firm level?	Section 4.3; Chapter 5
R6	Enhanced transparency and confidence in the audit process and increased perceived value for stakeholders (including improved reporting quality)	B: Does, s45 of the APA afford perceived legitimacy to South African external audit?  See also Question A: Do the provisions of s45 of the APA have a perceived impact on the quality control systems of audit firms?	Section 4.1, Section 4.3; Chapter 5; Chapter 6
R7	Enhanced sustainability for audit firms including reduction in overall audit risk	Question A and Question B	Chapter 4; Chapter 6; Chapter 7
R8	A sense of legitimacy in the eyes of the informed public	Question B	Section 4.3 Chapter 6; Chapter 7
R9	A sense of personal responsibility for auditors and auditors being held to account	C: Is s45 of the APA an example of surveillance machinery and a manifestation of disciplinary power?  (See also Question B)	Chapter 4; Chapter 5; Chapter 6; Chapter 7

**TABLE 3.6: STATISTICS FOR ROW CATEGORIES IN SYMMETRIC NORMALIZATION**

		Overall			Dimension_1			Dimension 2		
		Mass	Quality	%inert	Coord	Sqcorr	Contrib	Coord	Sqcorr	Contrib
R1	Development of a culture of leadership with more participation by the engagement leader (para 9)	0.089	0.895	0.08	0.546	0.775	12%	0.248	0.121	3%
R2	Awareness of the importance of ethical compliance (para 14 &18) including client acceptance and continuance procedures (para 28)	0.159	0.71	0.055	- 0.162	0.177	2%	0.323	0.533	10%
R3	Acknowledging the importance of resources & competency of engagement team (para 36) as well as the need for full compliance with ISA (para 46)	0.094	0.753	0.019	- 0.221	0.573	2%	0.142	0.18	1%
R4	Ensuring appropriate consultation on contentious matters and resolution of differences of opinion (para 51)	0.16	0.81	0.11	- 0.026	0.002	0%	0.559	0.808	30%
R5	More attention paid to internal quality control and continuous improvement processes including documentation standards (para 74)	0.064	0.9	0.225	- 0.904	0.544	24%	-0.84	0.356	27%
R6	Enhanced transparency and confidence in the audit process and increased perceived value for stakeholders (including improved reporting quality)	0.126	0.703	0.151	- 0.589	0.68	20%	- 0.124	0.023	1%
R7	Enhanced sustainability for audit firms including reduction in overall audit risk	0.054	0.501	0.085	0.284	0.121	2%	-0.58	0.38	11%
R8	A sense of legitimacy in the eyes of the informed public	0.14	0.547	0.03	0.165	0.3	2%	- 0.172	0.247	3%
R9	A sense of personal responsibility for auditors and auditors being held to account	0.114	0.936	0.246	0.841	0.768	37%	- 0.453	0.168	14%
					<hr/> <b>100%</b>			<hr/> <b>100%</b>		

**TABLE 3.7: STATISTICS COLUMN CATEGORIES IN SYMMETRIC NORMALIZATION**

		Overall			Dimension_1			Dimension 2		
		Mass	Quality	%inert	Coord	Sqcorr	Contrib	Coord	Sqcorr	Contrib
C1	RI's are to be reported to the IRBA	0.193	0.209	0.069	- 0.091	0.053	1%	- 0.178	0.155	4%
C2	Reporting to take place immediately vs. after 30 days under the PAAA	0.119	0.91	0.206	0.298	0.12	5%	0.878	0.79	55%
C3	Failure to report an RI could lead to liability and criminal sanction.	0.194	0.971	0.117	0.384	0.57	13%	-0.37	0.401	16%
C4	Wrongful reporting could lead to a claim for damages	0.204	0.752	0.063	0.27	0.55	7%	- 0.188	0.202	4%
C5	RI's include fraud, irrespective of materiality level	0.119	0.405	0.092	- 0.284	0.244	4%	- 0.266	0.162	5%
C6	RI's include a material breach of trust and fiduciary duty	0.09	0.613	0.072	- 0.014	0.001	0%	- 0.525	0.612	15%
C7	RI's involve management only	0.081	0.965	0.38	- 1.379	0.955	70%	- 0.161	0.01	1%

### 3.5: OVERVIEW OF RESEARCH QUALITY

The following is a summary of key threats to research validity and the approach taken to mitigate them<sup>59</sup>.

TABLE 3.8: VALIDITY RISK SUMMARY AND APPROACH TO MITIGATE THOSE RISKS			
Nature of the Risk	Threat to External Validity?	Threat to Internal Validity?	Description of Control
Weak framework - bias, unsubstantiated views or misconceptions characterise the literature review	✓	✓	<ul style="list-style-type: none"> <li>Articles sourced primarily from peer-reviewed journals and professional publications subject to due process</li> <li>Use of multiple sources</li> <li>Peer debriefing</li> <li>Presentation of aspects of the thesis at formal conferences</li> </ul>
Inaccurate or incomplete data due to errors or omissions in the correspondence analysis or interview agenda	✓	✓	<ul style="list-style-type: none"> <li>Independent review of the correspondence table and interview agenda</li> <li>Mapping of the agenda and correspondence table to the literature and research problems (Section 3.4; Section 3.5)</li> <li>Electronic recording of detailed interviews to extent practical/permitted</li> <li>Pilot study (Appendix B1) and considering the appropriateness of the correspondence analysis (Appendix B2)</li> <li>Peer debriefing</li> </ul>
Interview responses are contrived or not rooted in appropriate experience. The correspondence analysis is misunderstood and/or completed incorrectly	✓	✓	<ul style="list-style-type: none"> <li>Participants are recognized industry experts</li> <li>Use of defined agendas or interview protocols</li> <li>Basic instructions provided on how to complete the correspondence table (Section 3.4.2)</li> </ul>

<sup>59</sup> See also Table B2 (Appendix B5)

**TABLE 3.8: VALIDITY RISK SUMMARY AND APPROACH TO MITIGATE THOSE RISKS**

Nature of the Risk	Threat to External Validity?	Threat to Internal Validity?	Description of Control
			<ul style="list-style-type: none"> <li>• Responses are kept confidential and draft copies of the report are available on request</li> <li>• Peer debriefing</li> <li>• Pilot study (Appendix B1) and considering the appropriateness of the correspondence analysis (Appendix B2)</li> <li>• Contrast of results from interviews and the correspondence analysis with the prior literature</li> </ul>
Inaccuracies and bias weaken data collection and interpretation		✓	<ul style="list-style-type: none"> <li>• Use of the data analysis spiral to assess, review and condense data</li> <li>• Detailed descriptions of the findings</li> <li>• Use of correspondence analysis to complement the insights from the detailed interviews and vice versa (Chapter 5)</li> <li>• Follow up sessions to investigate identified themes and bias (i.e. quasi Delphi techniques)</li> <li>• Electronic recordings of responses.</li> <li>• Defined agendas and interview protocols</li> <li>• Use of predefined axial codes coupled with open codes developed during the study</li> <li>• Confidentiality of responses</li> <li>• 'Triangulation' of sources</li> <li>• Disclosure of limitations and delimitations</li> <li>• Peer debriefing</li> </ul>
Maturation of participants, participant mortality and participant bias		✓	<ul style="list-style-type: none"> <li>• Purposeful selection of experts at Big Four, second tier firms and academic institutions</li> <li>• Informed users selected from various organizations and regulators</li> <li>• Contrast of perspectives as part of data analysis</li> <li>• Adequate sample sizes (Section 3.3)</li> </ul>

TABLE 3.8: VALIDITY RISK SUMMARY AND APPROACH TO MITIGATE THOSE RISKS			
Nature of the Risk	Threat to External Validity?	Threat to Internal Validity?	Description of Control
			<ul style="list-style-type: none"> <li>Data collection carried out over short time period mitigates risk of maturation and mortality as well as the risk of general changes over time (such as cultural or political developments)</li> <li>Detailed findings and a presentation of arguments and counterarguments</li> </ul>
Readers attempt to use the study to make inferences due to limited sample size	✓		<ul style="list-style-type: none"> <li>Inability to make inferences to large populations is an inherent limitation of qualitative research and is disclosed in the limitations section of the report for transparency (Section 1.4.2; Section 8.3).</li> </ul>
Logic of conclusions is difficult to follow – application to related theories may be problematic	✓		<ul style="list-style-type: none"> <li>Triangulation of data from three sources as discussed above</li> <li>Peer debriefing</li> <li>Presentation of findings at conference proceedings and related publications</li> </ul>

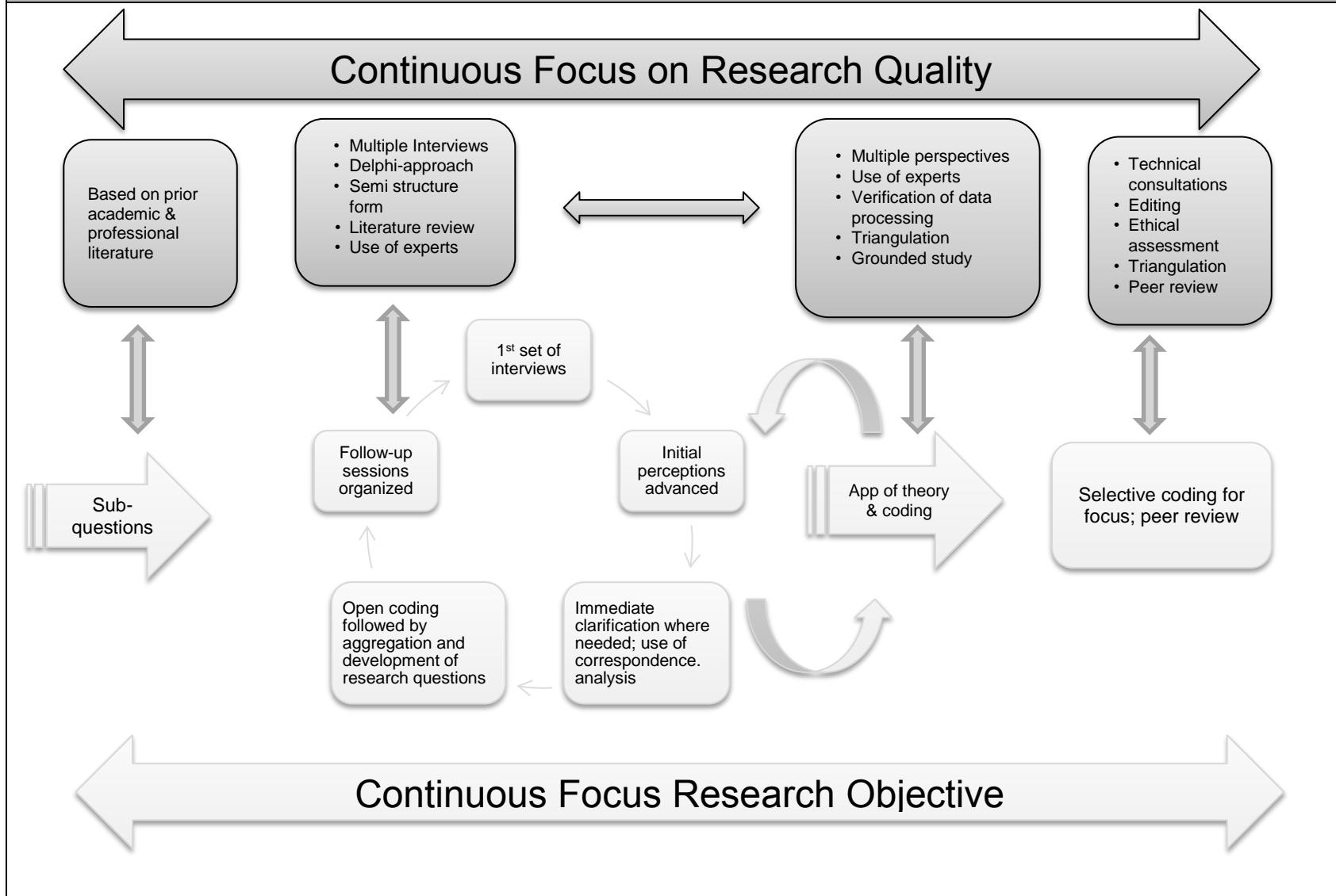
On a final note, this thesis has taken a number of steps to safeguard against ethical problems. In the interest of transparency, the methods, assumptions, limitations and delimitations have been disclosed while the anonymity of respondents and their respective firms has been guaranteed<sup>60</sup>. While every effort was made to avoid editing interviewees' commentary, any comments that could be used to identify the respondent or his/her place of employment were removed with amendments to the quotations indicated. In addition, as recommended by Creswell (2009), Holland (1998b) and Holland and Stoner (1996), participants were informed of the nature and purpose of the research, of their right to withdraw at any time, and have been offered a copy of the final report. As interviews can amount to 'moral enquiry' (Creswell, 2009),

<sup>60</sup> Interview recordings and transcripts have not been made available to other researchers. Further, as the researcher is a member of SAICA, and bound by confidentiality, interview transcripts may not be accessed by third parties.

the data collection instruments were reviewed by Ethics Unit at Kings College London (Appendix D) and were piloted (Appendix B3) with no material ethical concerns noted. As many participants were bound by professional standards or codes of conduct (IRBA, 2011; SAICA, 2012) the researcher and technical consultant paid special attention to ensuring that engaging in the research would not pose ethical problems for interviewees. Finally, digital recordings of the interviews and transcripts will be subject to strict access controls and will be retained on file for a period of two years after the completion of the study. Due to restrictions on the researcher in terms of the IFAC (2006), IRBA (2011) and SAICA (2012) codes of conduct, third parties will not be permitted access to this material. These ethical safeguards, coupled with the reliability and validity measures discussed above, ultimately provide reasonable assurance on the quality of this research. This is summarised diagrammatically by Figure 3.2:



**FIGURE 3.2: DIAGRAMMATIC OVERVIEW OF RESEARCH APPROACH**



### 3.6: SUMMARY

---

This study adopts a social constructivist world view. Individuals develop subjective meanings of their experiences, implying that phenomena can be studied by exploring multiple perspectives of participants (Chua, 1986; Kaplan and Ruland, 1991; Ahrens et al, 2008; Creswell, 2009). As a result, the study is a non-positivist one. The intention is not to simplify the research problem; to quantify audit quality, legitimacy or perceived disciplinary power; extrapolate findings; or seek a unique 'truth'. Rather, an interpretive methodological approach is followed with detailed interviews and, to a limited extent in Chapter 5, a correspondence analysis as data collection instruments. This approach allows for multiple perspectives of experts and informed users to be examined in detail, shedding light on a specific aspect of auditing systems.

A highly iterative, flexible data collection process inspired by grounded theory has been employed. A qualitative study of this form will not be able to produce a simplified model for 'quantification' of audit quality in a positivist fashion. This is not a shortcoming as the aim of this study is not to present 'scientific' fact or the 'optional solution' but to shed light on a social phenomenon. In doing so, the thesis speaks to the need for practically-inspired research in an auditing context, taking into account the insights of those on the 'front lines' of the audit profession (Power, 2003; Humphrey, 2008). As an added advantage, the thesis produces one of the first insights into audit practice, quality control systems and reporting from an African perspective and on whistle-blowing by external auditors in general. To this end, Chapter 4 and Chapter 5 discuss the first aspect of the RI provisions: their perceived impact on audit quality control systems. This will be followed by considering the association between the RI provisions and conceptions of legitimacy (Chapter 6) and notions of disciplinary power (Chapter 7).

## 4: INTERVIEW FINDINGS: AUDIT QUALITY AND S45 OF THE APA

---

This chapter explores the role of s45 with audit quality. As agency costs increase, Section 2.2 explains that the demand for high quality audit grows (Ashbaugh and Warfield, 2003; Solomon, 2009) and that additional external regulation may be one means of driving improved audit quality. This is especially true in the aftermath of market failures (consider Haigh and de Graaf, 2009; DeFond and Lennox, 2011). South Africa's RI provisions may be no exception.

The APA (2005) does not require the auditor to design audit procedures aimed specifically at identifying RI's (IRBA, 2006) and should not be interpreted as creating a statutory duty for the auditor to detect fraud<sup>61</sup>. Nevertheless, the RI provisions create a reporting duty over and above the traditional requirement to express an opinion on a client's financial statements (IAASB, 2009c; IAASB, 2009s; IAASB, 2009t) which are backed by sanctions for non-compliance and which could expose the auditor to litigation risk (IRBA, 2006; PwC, 2006). Accordingly the RI provisions may have implications for the level of engagement quality per ISQC 1, especially as, practically, whether or not the auditor has made a reasonable effort in complying with the whistle-blowing duty would be linked with the adherence to sound quality control principles. In this context, this chapter deals with the first research question (Section 1.4; Section 2.2.4):

### ***A. Do the provisions of s45 of the APA have an impact on the quality control systems of audit firms?***

This section is organised as follows<sup>62</sup>: Section 4.1 considers whether or not the provisions of s45 of the APA cause engagement leaders to take a greater leadership responsibility role on external audits (A1). An overview of the requirements of ISQC 1 is provided, followed by the perspectives emerging from the detailed interviews. Section 4.2 follows a similar structure and deals with the implications of s45 of the APA for the perceived importance of ethical principles

---

<sup>61</sup> For this reason, the possibility of the reporting duty contributing to an expectation gap, commonly associated with the auditor's perceived duty to *both* detect and report fraud (Humphrey et al, 1992; Humphrey et al, 1993a; Khalifa et al, 2007) is not specifically addressed. Related to this, several critical writers have argued that audit regulatory developments, as well as certain audit practices themselves, may form part of complex institutional or political processes (Fogarty et al, 1991; Sikka et al, 1998; MacLulich, 2003; Power, 2003; Humphrey, 2008). Such lines of thought are deferred to Chapter 6 and Chapter 7.

<sup>62</sup> Each of the sub-questions identified in Section 2.2.4 are addressed by this chapter.

(A2) and client acceptance and continuance protocols (including risk management) (A3). Section 4.3 explores the implications of the RI provisions for the perceived importance of human resource practices and engagement performance (A4); consultation, supervision and review (A5) and continuous improvement and firm-wide monitoring of quality controls (A6). Section 4.4 summarises respondents' comments.

---

## **4.1: ENGAGEMENT LEADER PARTICIPATION**

---

---

### **4.1.1: REQUIREMENTS OF ISQC 1**

---

ISQC1 follows a conceptual approach to leadership, consistent with that found in King-III (IAASB, 2009x; IOD, 2009). It avoids using 'enclosing controls' which simply reduce quality mechanisms to a set of rules, relying on a more flexible approach aimed at encouraging sound professional judgement (see also McMillan, 2004; Messner, 2009; Christopher, 2010). Accordingly, the standard requires audit firms to promote an internal culture which champions engagement performance quality. A firm's managing board of partners is, therefore, required to assume ultimate responsibility for the firm's system of quality control (IFAC, 2006; IAASB, 2009x). Clear, consistent and frequent 'actions and communications' by management are needed as well as a performance measurement system which ought to emphasise and align key performance indicators with the strategic drive for quality (see also Cohen et al, 2002; FRC, 2008a; IAASB, 2009x; Huntly, 2011; Oosthuizen, 2011). Of particular relevance is the establishment of policies and procedures to address compensation, promotion, assignment of responsibility and the provision of resources to 'demonstrate the overriding commitment to quality' (IAASB, 2009x, p. 13). In other words - echoing the provisions of codes of governance in South Africa, the UK and USA - the governance of the firm amounts to very little if the organisation's leadership and ethos do not embrace a commitment to high quality audit (see also Drury, 2005; IOD, 2009; Dillard and Roslender, 2011).

---

#### 4.1.2: PERCEPTIONS OF AUDIT EXPERTS AND INFORMED USERS

---

An internal culture of quality, including the need for engagement leader responsibility, has been well entrenched at audit firms, prior to s45 of the APA (E1, E3). Experts were unanimous in their view that auditing standards were being correctly applied and that the audit reports were appropriate. Few changes could be attributed to s45 of the APA barring the reminders given to staff of the professional duty associated with the respective legislation at the outset and during the course of audits. Similarly, performance evaluation, compensation, promotion, key performance indicators and strategic values were seen as audit-quality-orientated with the result that, for the firms' leadership, irrespective of the size of the firms involved in the research, it has 'been largely business as usual' (E4).

That there has been no change in the leadership role played by partners due to the presence of the whistle-blowing duty may be interpreted positively as an indication that South African audit firms have, historically, adhered to sound audit quality control principles:

'...Audit quality is basically what we are all about. We would actually be very worried if people started changing what they do [on an audit] because of an Act....If you could somehow plot audit quality on a graph showing [our firm's] audit quality three years before and after the introduction of [s45 of the APA] you would see no related change' (E2).

Additional involvement of engagement leaders when an RI is detected or suspected is, therefore, often largely procedural:

'Part and parcel of the risk assessment and response model embodied by ISA and [the respective firm's] risk management policy' (E7).

'You pretty much do the same as you normally would have, barring the extra paper work if you find an RI' (E5).

Expert 6, however, goes on to explain that, although few changes have occurred 'on the ground':

' I think the reality is that there [are] a lot more implications because of [s45 of the APA] and that places far more pressure on the *partner* - but whether that makes a difference in terms of quality of the audit opinion or quality of the audit, probably not' (E6).

While confirming that audit quality is not directly affected by the legislation, this comment highlights an individualising effect on engagement leaders, a sentiment shared by almost all

audit experts. Expert 9 for example, explained that while a 'firm's quality procedures comply with ISA and thus cater for dealing with RI's', there is a 'clear sense that *you* are the one who's ultimately accountable for the audit and I think that s45 [of the APA] is driving that message home'. Under the APA, experts pointed out that an *individual* registered auditor can be guilty of an offence for a failure to report an RI when he ought reasonably to have done so (s44 and 52 of the APA, 2005), providing an explanation for this sense of greater responsibility. Experts, however, describe engagement involvement when an RI is suspected mainly as a demonstrable act of compliance. The focus is not only on doing what is required, but being able to 'demonstrate that you are doing the right thing' (E12) potentially pointing to a 'tick the box mentality' (U11) which was identified by some respondents as a possible reason for s45 of the APA not leading to more substantive changes at the engagement level. By virtue of the fact that s45 of the APA has a set of rigid prescriptions to be followed in the event of detecting or suspecting an RI (IRBA, 2006), it becomes an example of an enclosing control that cultivates an attitude of 'blind compliance' (E5) and 'the result is that the auditor blows the whistle when he must. He has no enthusiasm or desire to do anything more or less than comply with the [the APA]' (E10).

Encouraging an attitude of compliance does not, however, mean that 'ticking the box' (E12) is all that matters. Under King-III (2009), a leadership body should be responsible and accountable for the actions and sustainability of the organisation. Section 45 of the APA emphasises this for at least some experts who reported a change in their attitude towards risk management:

'I think that, overall, there is at least some impact on partner leadership – but only because of the emphasis that is placed [on reporting]. [Complying with s45 of the APA] is largely an administrative issue...but the fact that [whistle-blowing] is legislated means that it is now more in your face...Just look at the number of RI's...That number has shot through the roof and I think one reason is that there is more focus on [reporting]. There is more awareness from partners that **they** have a responsibility for it...' (E1).

'What the legislation has done is make it clear that you are personally responsible for reporting shenanigans. You have a moral duty to do it and that leads to a sense of accountability for some auditors' (U15).

In other words, there is a sense that the legislation 'internalises' the reporting duty and that a type of social obligation arises to blow the whistle on certain transgressions (a line of thought explored in more detail in Chapter 6). Section 45 of the APA, therefore, becomes part of the broader social duty of the engagement leader, possibly linked to the idea of audit serving the public interest as argued by the legislature at the time of enacting the APA (Nel, 2001). Ethics

and a sense of professionalism also, however, have a role to play. Expert 5, refuting the argument that s45 of the APA led to more partner participation defended this opinion:

'I have a duty to the people that work with me to make sure that we do [the audit] to the best of our ability and also a duty to the client and its shareholders. I take my work very personally and having a sense of professional duty, I am worried about my own good name and the good name of my firm' (E5).

In this context, legislation itself had no real bearing. The name of the firm and sense of professional commitment were primary drivers of engagement leader participation on audits, pointing to 'personal beliefs' and professional appearance being a driving force for professionals (see also Edwards, 2001; Carrington, 2010; SAICA, 2012). Being more specific to the individual partners, these 'elements of audit quality' (E10; E5) were largely independent of the size of the audit firms, including the type of clients that different experts were dealing with. Likewise, most users – also being professionals – reached largely the same conclusions as experts<sup>63</sup>. Compliance with the legislation is still seen as an important issue that can lead to engagement leader participation, but higher levels of practical involvement by audit partners is, for almost all experts and users, better explained by a sense of professional duty and the personal values – including ethical principles - of the individuals in question.

## **4.2: ADHERENCE TO ETHICAL PRINCIPLES INCLUDING CLIENT ACCEPTANCE AND CONTINUANCE**

---

### **4.2.1: REQUIREMENTS OF ISQC 1**

---

Carrington (2010) and Wines (2012) argue that the auditor's professional standing, including both independence of fact and appearance (SAICA, 2012; Schmidt, 2012) are critical characteristics of high quality audits (Bazerman and Moore, 2011). The sentiment is shared by the IFAC (2006) and equivalent quality control standards in the USA (Bedard et al, 2008) which see independence of audit staff, and the culture of leadership driving firm-wide ethics, as highly

---

<sup>63</sup> The fact that most users expressed similar views to experts and that no differences were noted between the opinions of experts from the Big 4 audit firms and other audit service providers should be read in light of the limitations noted in Section 1.4.2.

important. A similar message is advanced in codes of corporate governance (IOD, 2009; Solomon, 2010).

In this context, ISQC 1 requires audit firms to promote an 'internal culture' which champions engagement quality, including the need to ensure the highest standards of ethical conduct. Threats to integrity, objectivity, professional competency and due care, professional behaviour and confidentiality (the fundamental principles) must, therefore, be identified and mitigated (IFAC, 2006; IAASB, 2009x, p. 5). In particular, the audit firm's leadership should pay attention to the ethical culture of the firm and promote firm-wide policies that stress the importance of ethical behaviour (IAASB, 2009c, p. 14). As discussed in Section 4.1, active and responsible leadership should be complemented by a performance measurement system which emphasises the relevance of audit quality and aligns it with the strategic objectives of the firm (see also Cohen et al, 2002; FRC, 2008a; Oosthuizen, 2011).

A conceptual approach to governance is followed where the audit partners are ultimately responsible for the ethical 'tone' of the firm and held accountable for ethical transgressions (IAASB, 2009x, p. 14). The standard focuses mainly on the need to identify and mitigate threats to compliance with the fundamental principles (FRC, 2008a; FRC, 2008b; IAASB, 2009x: 14; European Commission, 2010b), in line with the importance of professional standing and reputation identified by the prior audit quality literature (examples include Francis, 2004; Lim and Tan, 2008; Carrington, 2010).

While auditor independence is highly relevant in this regard, the clients with whom auditors are associated are also an important consideration (consider Carrington, 2010; Bazerman and Moore, 2011; Wines, 2012). The high quality audit firm, to ensure independence and sound engagement performance, needs to be selective with its prospective clients (Asare et al, 2005; IFAC, 2006; SAICA, 2012), a concept also featured in US GAAS (Bedard et al, 2008) and, at least to some extent, in codes of governance (IOD, 2009; Solomon, 2010; IRC, 2011). For example, ISQC 1 recommends that firms only undertake those engagements which they have the necessary resources and skills to execute and to avoid those engagements characterised by an unacceptably high level of risk (IAASB, 2009x). In this context, the standard requires the firm to develop client acceptance and continuance procedures designed to ensure that it is capable of executing engagements to the highest standards (see also Cohen et al, 2002; Asare et al, 2005; Farag and Elias, 2011; SAICA, 2012). Codification of client acceptance and



continuance protocols and documentation of the processes followed and conclusions reached complement this (see, for example, Cohen et al, 2002; Bedard et al, 2008; FRC, 2008a; IAASB, 2009x; Owoso and Weickgenannt, 2009; Farag and Elias, 2011). In other words, sound client acceptance and continuance work becomes an integral part of preventing and managing threats to ethical requirements (IFAC, 2006; IAASB, 2009x; IAASB, 2009e; IAASB, 2009d).

These principles are largely consistent with King-III which encourages the use of formal codes of conduct and effective leadership that cultivate a culture of ethical awareness (IOD, 2009; IRC, 2011). Although not directly addressing client acceptance and continuance by audit firms, King-III refers to sustainable business practices and effective risk management, which would include an assessment of an organisation's business relations. In this way, the auditor is expected to consider, not only the well-being of the firm, but also the client and those to whom the audit report is ultimately addressed (see also IFAC, 2006; Bedard et al, 2008; IAASB, 2009x; IOD, 2009). There is a sense of 'socialising responsibility' (Roberts, 1991; McMillan, 2004) focusing on the good name of the profession and the realisation that audit quality is rooted, to some extent, in the ethics and reputation of the audit firm (consider DeAngelo, 1981a; DeAngelo, 1981b; Sainty et al, 2002; Fernando et al, 2010).

---

#### **4.2.2: PERCEPTIONS OF AUDIT EXPERTS AND INFORMED USERS**

---

Experts generally indicated that a responsibility for policies and procedures aimed at ensuring compliance with ethical requirements, client acceptance and continuance assessments, driving a culture of quality and establishing the ethical consciousness of the firm has little to do with s45 of the APA:

'I don't think that we are more aware of ethical issues because of the reporting obligations. We would have all of the independence requirements and regulations that we would otherwise have to comply with anyway...irrespective of whether or not section 45 [of the APA] existed' (E6).

'In any event, the independence rules are so hectic that I think [the RI provisions] are covered...' (E7).

'[Independence]...that is the hallmark - the cornerstone of our profession: quality and independence. Nothing else is really important. So those things: quality and independence cannot

be driven by simple regulation. Barring existence of certain admin issues, that means that it's pretty much been business as usual' (E2).

Further, on the issue of client acceptance and continuance, s45 of the APA was described by most experts as having been 'discounted' into the overall risk assessment process, particularly as part of the consideration of a client's adherence to laws and regulations and principles of good governance. One expert, however, took a more critical view:

[When it comes to the firm's policies on independence] section 45 does not do a single thing, whatsoever, for me, regarding any ethical issues. Nothing whatsoever! If we are independent of the client, we are independent of other reasons...I want to comply with [the independence requirements] because of what I am as an auditor. There is no rule or section in any Act that will make me more ethical than I already am. That is just the way it is. As a professional accountant, that is what you do. You do not need a section in an Act to make you more ethical. I don't think it's even possible. You are either ethical or you're not' (E5).

For several experts, the need to adhere to the fundamental principles was deeply engrained in what it meant to be a professional accountant. Most experts stressed that they felt a personal and professional duty to both their firms and the shareholders of respective clients to discharge their duties to the best of their ability and that s45 of the APA is 'just an add-on' (E9). This sense of professional duty, particularly towards a client's shareholders (as opposed to the client directly) points to a post-conventional level of moral awareness. Sweeny and Roberts (1997: 338-240) describe this as a cognitive state characterised by heightened ethical sensitivity and decision-making, conforming with organisational values and 'internally held beliefs.' For several experts a desire to adhere to their respective firms and IFAC (2006) codes, subject to the context in which they were operating, suggests ethical reasoning at the post-conventional level. As explained, while codes of conduct are important:

A 'holistic response to independence is needed' (E5), taking the surrounding factors and context into account (E9), including a 'personal assessment of what it means to *you* to be a professional' (E8) with the result that 'just following the rules without thinking about them isn't the way to go' (U15).

Emotive references to the duty to shareholders (rather than the client itself), 'moral duty' (E13) and 'holistic responses to independence' (E5) imply a sense of social commitment and moral 'rightness' (E11). There is more to ethical requirements than just compliance with a code to ensure behaviour consistent with 'referent group norms'. Actions must also be consistent with 'internally held beliefs' and values (Sweeney and Roberts, 1997, p. 339). Prescriptions of the APA do not, in themselves, lead these partners to be any more or less aware of the importance

of ethics echoing the findings of Sweeny and Roberts (1997) and McMillan (2004) - that rules and regulations do not materially affect ethical conduct for all professionals. Analogously, many experts are not motivated by prescriptions and sanctions of the APA and a majority of users reached a similar conclusion on the limited role of the RI provisions when it comes to auditor ethics. Instead, there is a sense of idealism, a notion of public service and sense of duty to oneself, one's firm and society (see also Edwards, 2001; Carrington, 2010; SAICA, 2012). Using client acceptance and continuance as an example, experts noted that:

'Despite the need to generate a profit you don't want a client if it the client causes material threats to independence' (E2).

'At the end of the day, you are accountable to the whole firm and, in a way, to the profession, and to the *shareholders* of clients and that means that sometimes client fees need to take second place. You have a moral duty as a professional accountant – don't forget that' (E17).

'Besides, if the client is a crook, he will probably always be a crook and you don't want that person as your client....you don't want his fees' (E5). 'And that is not just the textbook answer, because I am worried about what you [the researcher] may want to write about. **That is the honest to God truth about it**' (E4, emphasis added).

Several experts reiterated these views, defending the decision to reject a client-based personal assessment and not by defaulting on professional standards. In each case, there is a sense of moral and professional duty that overrides the profit motive. For the majority of experts, codes of conduct are described as secondary, being used to corroborate experts' opinions rather than form the basis of those opinions. Organisational standards and norms for client acceptance and continuance must be consistent with the internally held beliefs of these professionals, irrespective of perceptions, economic incentives and the size of the respective audit firms<sup>64</sup>. In summary: 'we need to know that we have delivered a proper audit report' (E5), 'not just for the firm, and because of the quality control procedures, and [s45 of the APA], but also for me, *personally*' (E14). Consistent with Sweeney and Roberts (1997), the prescriptions of the APA are not always material. 'At the end of the day, it wasn't as if s45 came out on Monday and suddenly there was a mad rush upstairs [to change our firm's client acceptance policies]' (E1).

Experts also confirm the prior findings of, *inter alia*, Carrington (2010) and Guenin-Paracini (2010): that professional appearance is an important 'element' of audit quality, complemented by brand awareness and reputation of the audit firm:

---

<sup>64</sup> See, however, the delimitations in Section 1.4.2

'It comes back to the whole issue of: it's your name on that file; it's your name on that audit report. Once the client is a criminal, he won't change...and there is no way that / can [continue to be that client's auditor]' (E5).

For *all* experts there is a need to preserve one's own name, the good name of the firm and of the profession which reaffirms a sense of moral and social duty and preservation of the reputation of the individual partner and the firm. This is far more relevant for ethical awareness than simple adherence to professional standards and the rules of s45 of the APA. In particular, with external audit processes not being directly observable, professional appearance becomes pivotal (Carrington, 2010). This is not just a function of the independence of the auditor but also the clients with whom the auditor is associated. Without being able to 'calibrate the assurance axis' (Power, 1999, p.28), while expert judgement and technical expertise are important, they must be reinforced by professional appearance (Carrington, 2010). As put by Pentland (1993), what audit experts strive for is the preservation of faith in the 'sacred signature' - a concept explored in more detail in Chapter 6 - more than just adherence to s45 of the APA. As was the case with Section 4.1.2, with users being able to identify with the relevance of professionalism, including a sense of duty to one's firm, most shared similar views with experts operating at post-conventional levels of moral cognition.

For some auditors, however, ethics and professionalism are frequently expressed in terms of compliance with organisational norms or professional codes and these individuals tend to be less sensitive to issues not embodied by those codes (E5; U10). By creating a duty to report certain client transgressions, s45 of the APA 'drives home' the duty of the auditor to 'serve as a watchdog' (U2) and, coupled with that, the importance of independence of fact and appearance. In addition, several respondents commented that there was a tension between reporting duties which depart from the principle of client confidentiality and the business case for managing client relationships, a sentiment shared by the prior literature (Wyatt, 2004; IFAC, 2006; Wielligh, 2006; Bazerman and Moore, 2011) Section 45 of the APA may have a role to play in managing this tension:

'In any relationship...between yourself and the client, invariably you are going to get to a point where you are in a tight corner. And when you're in that tight corner, you need avenues to get you out of there. Almost like an escape hatch. And this legislation might be that escape hatch' (E3).

'It would frustrate me to no end knowing that there is something wrong and not being able to do anything about it. It implicates you. You become part of it. At best, all you can do is tell the client to go and find another auditor. Ultimately, it would burn me to say, "I know that you have done wrong and there's really nothing I can do about it". So, the reporting duty has to stay. It gives a level of

protection to the audit profession. They have been given an important outlet to sound the alarm...and you can always come back and say you did it because of the legislation' (U10).

Paradoxically, despite its penalty provisions, s45 of the APA becomes an independence safeguard. Firstly, it resolves the dilemma of 'reporting transgressions when in the public interest to do so, even if the audit report is unqualified' (U1) despite client confidentiality requirements (IFAC, 2006; IAASB, 2009g). This would be especially significant for those auditors dependent on rules and regulations both to define and resolve ethical dilemmas (Sweeney and Roberts, 1997). Reporting guidelines backed by fines and penalties (s52 of the APA) - and not based solely on professional judgement (IRBA, 2006) and 'internally held moral conceptions' (Sweeney and Roberts, 1997) - can influence decisions on reporting of wrongful acts for some auditors. In this context, s45 of the APA was seen by several experts as part of the broader regulatory machinery driven largely by developments overseas, such as SOX, working to reinforce independence of fact and appearance (U13). Litigation risk complements this and, per Palmrose (1988; 1997) and Deng et al (2012), can have a bearing on audit quality:

'The international firms [which include the Big 4 in South Africa] are always concerned with the risk of litigation...perhaps even more so than reputation...and remember that [s45 of the APA] may give the client a cause of action....so it [the whistle-blowing duty] capitalises on the whole issue of litigation risk and so the audit firms are probably worried about it and make sure they comply with it (U3)'.

Respondents referred to the relative inefficiency of the South African Legal System and the absence of matters concerning s45 of the APA being taken before the courts. The general sentiment, however, was that the mere existence of mechanisms that could criminalise the auditor's conduct and lead to civil action is probably sufficient to motivate the auditor to report transgressions and add to the quality of the reporting process, a line of thought explored in more detail in Chapter 6 and Chapter 7<sup>65</sup>.

Secondly, by qualifying the report or blowing the whistle on the client in the absence of the APA (2005), several experts stressed client relations could be tarnished, leading to economic pressure to circumvent reporting. (This could be particularly pertinent for smaller audit practices which are more dependent on any one client and have fewer financial resources (E13), although experts agreed that even for larger firms, this would remain a relevant consideration.) By requiring acts leading to material financial loss, any fraud (irrespective of perceived significance)

---

<sup>65</sup> This is not to say that auditors would never consider simply disregarding s45 of the APA. This possibility is explored in more detail in Chapter 7.

and material breaches of fiduciary duty (a 'vague catch all' per User 1) to be reported 'without delay' – rather than within thirty days (Section 2.1.3) - it becomes difficult to rationalise not reporting something, when it is in the public interest to do so, in the name of maintaining the client relationship and fees (U1; U2).

Similarly, from the auditor's perspective, the legislation becomes an 'independence shield'. Threats to compliance with the fundamental principles can be overcome as 'when the client starts to complain, you fall back on the statutory duty' (E8):

'When they found something wrong, [auditors] wanted to know how to report it without effectively "ratting out the client". So they came at it from the angle of, well, I'm obliged to [report to the IRBA]...not just because "I am a good citizen" because, even if I am "a good citizen", but [I am] not obliged to [report an irregularity], then one may ask, "why should I then [report the issue to the IRBA]?" But, when I am obliged to do so, at least I can say I was forced into it. So the legislation is a nice "escape valve"' (U1).

Finally, as explained by Hwang et al (2008), Kaplan and Schultz (2007) and Schultz et al (1993), s45 of the APA may be a means of formalising what was loosely described by respondents as a 'whistle-blowing requirement', reducing the need to apply professional judgement when resolving whether or not to report transgressions. It also appears to lower the perceived personal costs of reporting to the IRBA in that the legislation 'shields' the auditor from client dissatisfaction with the result that transgressions that may have gone unreported, due to economic pressure on the auditor or difficulties deciding whether a reporting duty exists, are brought into the open. This may be particularly true for smaller audit firms which could be more economically dependent on any one client (E13). From this perspective, users felt that the legislation reinforces auditors' professional reputation and objectivity, aligning the auditor with the public image of the 'watchdog' (U4) (Chapter 6). Users generally confirmed the suspicions of Sikka et al (2009) McMillan (2004) and Pesqueux (2005): that capitalistic pressures at work on the audit firm could lead to compromised independence standards and a failure to report faithfully the findings of the audit. Section 45 of the APA was interpreted by these users as partially addressing this risk.

## **4.3: HUMAN RESOURCES, ENGAGEMENT PERFORMANCE AND MONITORING**

---

### **4.3.1: REQUIREMENTS OF ISQC 1**

---

Professional appearance and independence alone are not adequate. If the ‘rituals of verification’ (Humphrey et al, 1992) do not measure up to expectation, the professional image is eroded and notions of high quality audit may be lost (Humphrey and Moizer, 1990; Humphrey et al, 1992; Carrington, 2010). For this reason, both ISA (IAASB, 2009x) and US GAAS (Bedard et al, 2008) stress the need for sound human resource practices, engagement performance and continuous quality control improvement.

Under ISQC 1, audit engagements ought to be executed to the highest standards in accordance with ISA and relevant regulatory requirements (IAASB, 2009x; PwC, 2010). The objective is to execute an engagement with a mind to reducing audit risk to an acceptable level, allowing the auditor to enhance the degree of confidence of intended users in a client’s financial statements (IAASB, 2009c) To achieve this, engagement teams require appropriate skills, resources and ethical standing to discharge their professional duties (IFAC, 2006; IAASB, 2009x).

Concurrently, audit staff must be held accountable for compliance with the firm’s system of quality control, which should be clearly documented and communicated to all levels of the audit firm (FRC, 2008a; IAASB, 2009x). An audit partner with adequate time and expertise should be identified as responsible for each engagement to ensure maximum quality at the engagement level (IAASB, 2009e). Ultimately, the skill-sets of the engagement team, including the partner, must reflect the nature of and risk associated with the client (IAASB, 2009x), a requirement reinforced by s44 of the APA. The aim is to ensure that the audit firm only undertakes those engagements which it is competent to perform (IFAC, 2006) consistent with the essence of codes of corporate governance (Christopher, 2010). This does not mean that every team member is expected to be an expert but it does necessitate supervision, monitoring and review by more experienced team members (IAASB, 2009x).

‘Review’ is the formal examination of the work of junior staff by those with more experience to evaluate its adequacy (IAASB, 2009x). To ensure that the time, experience, expertise and judgement of junior staff is assessed as facts and circumstances change, supervision caters for

monitoring and mentoring by experienced team members. Supervision and review are interconnected processes with review frequently driving additional testing based on an assessment of the sufficiency and appropriateness of the audit evidence gathered to date. It allows for senior members of the audit team to assess whether or not testing meets the objectives of the engagement and affords them an opportunity to immerse themselves in the details of the audit work performed. In turn, this allows for a continuous examination of audit risk and evaluation of the nature, timing and extent of required audit procedures (IAASB, 2009g; IAASB, 2009l; IAASB, 2009m; IAASB, 2009x; Owhoso and Weickgenannt, 2009).

Supervision and review may also trigger the need for consultation. As auditing requires professional judgement (Bedard et al, 2008; IAASB, 2009a) consultation on difficult and contentious matters serves as a quality safeguard (see also: Bedard et al, 2008; Owhoso and Weickgenannt, 2009; Nagy, 2012). By calling on the 'collective experience and technical expertise of the firm' (IAASB, 2009x, pp. 19-20; IAASB, 2009c) complex and subjective issues are more thoroughly assessed; differences of opinions can be explored and resolved; and conclusions are more consistent. Formal documentation then ensures the posterity and transparency of the consultation process. In this way, consultation, monitoring and review speak to the need for 'risk governance and management', per King-III, by the firm's leadership.

Continuous assessment and improvement complements the 'risk governance' processes. ISQC 1 requires audit firms continually to assess the design, operation and effectiveness of their quality control systems, including reviews of each engagement leader's audits (IAASB, 2009x). This should be vested in the hands of suitably experienced individuals to drive the need for improvement; reinforce existing capabilities (consider, for example, Drury, 2005; Botten, 2009; Grafton et al, 2010); and prompt remedial action as needed (FRC, 2008a; IAASB, 2009x). The results of these quality reviews should be communicated at a firm-wide level to drive a culture of continuous improvement (see also Merchant, 2008; Botten, 2009; IOD, 2009).

For the benefits of consultation, monitoring, review and quality assessment to be realised appropriate documentation is paramount. It allows for a formal record of the activity over the course of the audit to be tracked and assessed, facilitating improvement, supervision, third party review, staff accountability and transparency (from the perspective of the audit team). Documentation also provides evidence of compliance with ISA, ethical standards and statutory requirements (IAASB, 2009x; IAASB, 2009f).



---

### 4.3.2: PERCEPTIONS OF EXPERTS AND USERS: EXECUTION OF ENGAGEMENTS

---

Experts reported little impact from the RI provisions on audit firms' human resources, engagement performance, monitoring, review and continuous improvement processes, irrespective of the size of the respective audit firms:

'I would not say that the legislation has a direct effect. Every year you strive to improve quality because you acknowledge that your [audit] file is never perfect. I think the focus has been more on the ISA clarity project and changes in accounting and auditing in general. At the end of the day, the Act has been around for a while' (E7).

This view is largely consistent with the fact that the objective of an audit is to express an opinion on the financial statements (IAASB, 2009c; IAASB, 2009s). While s45 of the APA creates a duty to report certain transgressions to the IRBA, it does not require the auditor actively to seek out RI's (IRBA, 2006). The RI provisions are seen simply as a part of the audit process - particularly considering a client's compliance with laws and regulations (IAASB, 2009h).

Where the legislation appears to have most relevance is for consultation, with the majority of experts indicating that the decision to report would require considerable discussion with peers, irrespective of the size of the audit firm. On the one hand, this is driven largely by the desire for accurate and correct reporting (E6; E1); avoiding unnecessarily upsetting client relations (E3; E9); and preserving professional appearance (E6; E7). On the other hand:

'[Consulting on an RI] is purely to make sure that we are complying with the Act....It's about making sure you tick the box' (E5).

'The idea is that [the audit team] will at least talk about [RI's] so that they at least have reportable irregularities at the back of their minds...We need to be able to say to a regulator that we are thinking about reportable irregularities at the appropriate point in the audit' (E8).

'We have the standard agenda for our [planning meetings]. It's the same – you tell the team what an RI is and what to do if you find it' (E2).

'There might be a generic risk that causes us to put out an alert [to our staff]...but I don't think that the reporting duty has been a trigger for anything that we have done' (E8).

'...and there are the standard [requirements] on the audit file where you have to consider if you have discussed the legislation with the team and have documented your rationale for reporting or not reporting something (if necessary). And after that, you sign it off and it's done' (E7).

To an extent, standardised documentation for RI considerations and review thereof is designed to ensure that reporting decisions are consistent and appropriate, as per Ashton (1992) who argues that mechanical aids can improve judgement performance. This may be especially important in an auditing context given a heuristic approach rooted in reliance on professional judgement (Owhoso and Weickgenannt, 2009; Hardies et al, 2011). Litigation risk is also relevant. *Bona fide* reporting to the IRBA when, in fact, no irregularity has taken place, may lead to civil action against the auditor (IRBA, 2006; Maroun and Gowar, 2013). Conversely, a failure to report when one ought reasonably to have done so may result in fines or imprisonment (s52 of the APA). Consistency and accuracy of the judgement process, rather than being related to the drive for audit quality, is more about ‘making sure that we are covering the firm’ (E5) and, due to the consequences for the reputation of the individual partner, ‘covering your own arse’ (E7). Documentation is inextricably linked to this, providing a formal record of the auditor’s considerations to justify the act of reporting or not reporting to the IRBA (E5; E6).

On the matter of engagement execution, changes to ‘consultations, staffing, skills and resource assessment and monitoring’ and ‘audit ground work’ are ‘simply part and parcel of quality developments in general’ (E1). While having to comply with the APA, firms have also been required to comply with, *inter alia*, SOX, changes to the professional standards and resulting internal quality requirements making it practically impossible to attribute specific changes in engagement performance to s45 of the APA. Accordingly, the reporting duty seems to be correlated more with a sense of self-preservation and protection of both the firm and individual partner from a risk of litigation or professional sanctions than with a valuable driver of audit quality. An exception is the issue of audit reporting where s45 of the APA appears to have a material impact.

---

#### 4.3.3: PERCEPTIONS OF EXPERTS AND USERS: REPORTING

---

For the CESR (2007), European Commission (2010b; 2010a), and the IAASB (2012), of particular relevance is the extent and quality of information being made available by auditors to stakeholders. When it comes to the quality of information reported by the auditor in the context of the RI provisions:

'At the end of the day, it's only really the auditor who understands the [audit] report...which has been crafted to cover the auditor...[At least s45 of the APA] gives flavour to what the auditor is reporting' (U3).

'The auditor report doesn't report on everything that the auditor finds...There is also a lot of judgement [in deciding whether or not and on what basis to qualify the audit report]. So, there will always be different interpretations' (U7).

Humphrey et al (1993b), Chandler et al (1993), Hassink et al (2010) and Edwards (2001) point to an 'expectation gap' when it comes to the duty of auditors not only to report on fraud (an example of an RI) but also to detect it. The RI provisions do not resolve the latter problem with the 'nuts and bolts of audit' not changed by the legislation (U2). Respondents, pointing to the practical difficulties, cost restrictions, and time constraints of including fraud detection in the auditor's mandate, agreed with s45 of the APA stopping short of requiring the active detection of RI's.<sup>66</sup> Where, however, an 'expectation gap' is *practically* addressed is with the nature of what is reported. Examining the nature and extent of the audit expectation gap in the UK and New Zealand, Porter (2012), for instance, finds that many perceived deficiencies associated with differences between reasonably expected audit functions and those required by professional standards could be ascribed to inadequate reporting of information which could be readily accessed by the auditor without undue cost or effort (see also Humphrey et al, 1993a). From this perspective, in the absence of s45 of the APA,

'one [would] not normally see [various transgressions] coming through in the emphasis of matters paragraphs<sup>67</sup> [of the audit report]. Normally, the emphasis of matter is only about a going concern [problem]...so in many respects the quality of the audit report that is issued, including in the absence of legislation, is inadequate....What s45 of the APA does is expand on what is required from the auditor' (U3).

'What we are reporting for the purpose of the legislation is factors that may impact the risk environment that we are auditing but which do not necessarily impact the financial statements...so I think the legislation serves a complementary purpose. It can alert users to the issues around

---

<sup>66</sup> Experts and users were unanimous in this view. This does not imply that an expectation gap does not exist. What is more likely is that users, being highly informed of the audit process (Section 3.3), do not have the same varied expectations as, for example, a general investor. Further consideration of the auditor's duty actively to detect fraud, and its contribution to an audit expectation gap, is beyond the scope of this research (Section 1.4.2; Section 8.3).

<sup>67</sup> An emphasis of matter paragraph is included in an audit report to draw a user's attention to certain facts or circumstances without modifying the audit report (IAASB, 2009t).

corporate governance – and some of that might not normally have come through the audit opinion’ (E8).

Interviewees explained that the traditional reporting duty of the auditor could, to some extent, be seen as passive or too generic (European Commission, 2010a; IAASB, 2012). The RI provisions can be interpreted as complementing the auditor’s standard reporting requirements with a more proactive approach (Section 4.3; Section 6.1) that requires the auditor to report transgressions and effectively demonstrate a commitment to the public interest (Nel, 2001; Opperman, 2009). A similar sentiment was shared by the Minister of Finance commenting on the promulgation of the PAAA (1951) and genesis of the auditor’s whistle-blowing duty (Section 2.1.4):

‘A most important aspect of this piece of legislation is Parliament’s recognition of the principle that an auditor owes a duty not only to his client but also to the public. For many years auditors have been in doubt as to their responsibility to the public. Parliament has now given a clear and unequivocal answer’ (Minister of Finance of the Republic of South Africa cited in Nel, 2001: 318).

Clarifying this view:

‘So, to sum up, basically, what s45 [of the APA] is saying is that the auditor cannot just give a generic audit opinion any more. He is expected to blow the whistle on shenanigans because, as a professional in a position of trust, he owes this duty to the users of the audit reports’ (E16).

Respondents pointed to the possibility of RI’s being useful for investors even though they may have no material bearing on the financial statements or traditional audit report. For this reason, simply legislating compliance with professional standards is not enough as ‘you can comply perfectly with ISQC 1 and still not report [an RI]’ (U1). For example a failure to pay certain taxes may have no material impact on the financials but could be relevant for the investor wanting to assess the ‘moral status’ of the firm or its inherent risk (E3). The South African Revenue Services may be extremely interested, even if the amounts are below the auditor’s materiality levels (E4). The companies’ regulator may want to know if annual general meetings are taking place or the relevant statutory returns are up-to-date (U7). Similarly, trade unions, environmentalists, or lobbyists could find an RI telling, depending on its nature and irrespective of the effect on the financial statements (E14). The end result is that ‘we have an independent and external way of reporting these problems’ (U7) and ‘by airing the dirty laundry...there are fewer unpleasant surprises’ (E17).

Accordingly, s45 of the APA becomes an important part of the corporate governance landscape. Respondents pointed to how the whistle-blowing duty enhances stakeholder decision-making by virtue of the fact that improprieties - not otherwise divulged in the audit report – are effectively brought into the public domain. As such, most respondents agreed that, to at least some extent, the RI provisions were important for improving corporate governance compliance and enhancing a sense of transparency and accountability on the part of auditees (Section 6.1; Section 7.1). This thinking is confirmed by the views on whistle-blowing in general as a communication and transparency enhancing mechanism (examples include Vinten, 2000; Nel, 2001; Vinten, 2003; PwC, 2011b). The fact that irregularities can be brought into the open effectively enhances decision-making processes concurrently adding to corporate transparency and encouraging compliance with existing governance standards (Vinten, 2000; Vinten, 2003; Kaplan and Schultz, 2007; Opperman, 2009; ICAS, 2010; Reckers-Sauciuc and Lowe, 2010).

The prior literature on whistle-blowing identifies two primary reporting impediments: the fear of retaliation and uncertainty as to when a reporting duty exists and who ought to report (Staub, 1978; Near and Miceli, 1995; Kaplan and Whitecotton, 2001; Seifert et al, 2010). For informed users, both limitations are addressed by the RI provisions which are embodied in law and define when one should report, complemented by the IRBA's guide (2006). As explained by User 1:

'I don't think that s45 has changed anything [in terms of how audits are done] but when [the auditor] stumbles upon [an RI] that is where the difference lies. Now, there is no longer the quandary of should I report because I am a good citizen or because of some common law ideal...In some cases, reporting is very easy. Consider the ludicrous situation where the client is dealing in drugs. Nobody would have a problem reporting that. But when you look at more difficult cases, like tax fraud, why should I report that? It's very easy when its drugs or arms or outright theft...but when it's not the easy cases? It's much more difficult to reach the conclusion: yes, I must report' (U1).

As discussed in Section 4.2, respondents also felt that the legislation provided a 'shield' for the auditor, allowing him to justify reporting to a disgruntled client on legal grounds, with fines and penalties increasing the cost of non-reporting as an added incentive (Chapter 7). The result is that, 'in the absence of the legislation, there might never have been an obligation or incentive to tell anyone' (U3). Concurrently, some respondents pointed to the external auditor as offering a confidential and secure whistle-blowing mechanism for staff at a client who, in the absence of the RI provisions may have been required to blow the whistle themselves with the result that perceived fear of retaliation would undermine effective reporting (see, for example, Hwang et al, 2008; Seifert et al, 2010).

This is not to say that every reportable irregularity is useful. A major criticism of s45 of the APA is that, unlike its predecessor, the APA requires any act of fraud, even if otherwise immaterial, to be reported (PwC, 2006; Wielligh, 2006).

'An unintended consequence may indeed be over-reporting and a dilution of the usefulness of reports. It's almost like a spam attack' (U3).

'I can't, [therefore], help wonder if we won't end up crying "wolf" so many times that the people stop paying attention to what we are saying' (E17).

Having to report 'without delay' (IRBA, 2006) rather than being afforded a 30-day period to discuss and resolve the matter with the client first (Section 2.1) is arguably compounding the problem by leading to premature reporting (U1; E5: U10). Some experts even went so far as to argue that the reporting timelines could lead to disclosure of incorrect facts, itself a threat to auditor integrity and objectivity (E5; U10). On the whole, however, the majority of users and experts were in favour of the RI provisions. In particular, users were of the opinion that the reporting process needs to cater for the information needs of a broad group of users, a concept fully consistent with a stakeholder-centric view on corporate governance (Christopher, 2010; Solomon, 2010) and the approach adopted by the IASB (2010) with respect to financial reporting<sup>68</sup>. For example,

'You can't be biased and say that because *you* found XYZ inconsequential that someone else won't. Look at the [South African Revenue Services] – they don't care if it was a R10 fraud or a R10 million fraud. For that particular user, that is material and it should be reportable...and in that light because the user group is so broad it makes sense to get rid of the "materiality requirements" [per s20(5) of the PAAA]' (U3).

From a slightly different perspective, the refinement of the reporting duty can be explained as narrowing a type of 'whistle-blowing expectation gap'.

'When we had material irregularities, hardly any got reported. Clearly we had the auditor setting the materiality thresholds and [regulators] were thinking about materiality in their own way....and the two just weren't aligned' (U2).

User 10 elaborates on this, explaining the increase in the number of RI's reported compared to MI's before the enactment of the APA:

---

<sup>68</sup> Users and experts agreed that RI's probably had more impact when it came to larger firms which would likely be audited by one of the Big 4. This was not a reflection on the effect of the size of the audit firm on reporting. Instead, as larger clients tend to be listed, more complex, and characterised by more stakeholders, whistle-blowing in these contexts was felt to be more value-adding.

'One of the reasons why there were so few material irregularities reported was [due to the application of professional judgement]...Relying on professional judgement may be the best approach, theoretically...but what does that actually mean? How would you interpret that?...The number of irregularities reported have definitely gone up because the legislation acts like a catch-all. If you are the auditor of the company, now also auditing the integrated report, and [an irregularity] comes to your attention, you have to report...[and] that resolves a type of expectation gap between what the auditor actually reports and what the general user would expect him to report' (U10).

In other words, the RI provisions are addressing the issue of the application of professional judgement leading to inconsistent conclusions regarding whether or not an irregularity ought to be reported. This, together with a type of independence safeguard – as discussed above – implies that the legislation is promoting a 'culture of reporting which is critical for sound functioning of our capital market, even if the cost of this has been that some trivial matters have been reported' (U2)<sup>69</sup>. Added reporting by the auditor also addresses the expectation that auditors do more than just issue a standard report lacking in depth (E18). This allows the attest function to be akin to 'a public watchdog' (U2; E10) (Section 6.1), thereby adding to the image of auditor independence. Further audit experts suggested that the RI provisions create an independence safeguard, allowing auditors to report transgressions using the legislation as a 'buffer' with the client (Section 4.2). The change from the PAAA (1951) to the APA (2005) whereby any instance of fraud is reported, even if perceived as immaterial, contributes to this by creating 'layers of independence' (U2; U5). The decision on whether or not an irregularity is sufficiently material to inform a relevant third party is vested with an independent body, the IRBA (IRBA, 2006). Several respondents, therefore, felt that the issue of clients using materiality levels to pressurise the auditor to refrain from reporting is rendered moot (E3; U7). The same may apply to the removal of the 30-day window period (U7; U3) which could have been relied upon to circumvent the reporting duty (Nel, 2001) thereby ensuring more active and effective reporting by auditors.

While most experts were unanimous that complacency did not lead to irregularities being ignored, acceleration of reporting duty was, nevertheless, important for the perception of auditor reporting, according to both users and experts (Chapter 5; Chapter 6):

'[Under the PAAA or the absence of s45 of the APA] the auditor would actively help the client to fix the problem because it has created a problem for the auditor as well....but at least the legislation now crystallises [the reporting duty]...[The problem] doesn't just get hushed up' (E1).

---

<sup>69</sup> The relevance of requiring matters that would otherwise be regarded as 'trivial' (U2) to be reported is discussed in more detail in Chapter 7.

'Is there a possibility that if we revert to the 30-day window period or requirement to report only "material" fraud that the auditor might be talked out of reporting or might try to avoid reporting? I think that that is part of the risk that the legislature is trying to deal with. And it's difficult to say that that didn't happen' (U10).

Returning to the whistle-blowing literature, uncertainty over what and when to report can stifle effective reporting (Leeds, 1963; Near and Miceli, 1995). The requirement to report any act of fraud, material financial loss and material breaches of fiduciary duty (Section 2.1; Appendix A1), while creating a problem as to precise meaning (E1; U10; IRBA, 2006), paradoxically overcomes threats to non-reporting. By creating a 'general catch all that can trigger a report being sent to the IRBA' (U1), the RI provisions resolve the technical problem identified by, *inter alia*, Kaplan and Whitecotton (2001) and Near and Miceli (1995), of when a reporting duty results, albeit by simply increasing the scope of the reporting duty (Nel, 2001; Wielligh, 2006). Concurrently, by erring on the requirement to report rather than refraining from doing so, several respondents argued that the auditor is protected because:

'It cannot later be said that [the auditor] should have reported an irregularity and that he failed to do so because of a failure of professional judgement or independence standards' (U13).

Instead, a conservative approach is taken with an independent regulator left to decide which reports are escalated (IRBA, 2006). Together with sanctions under s52 of the APA, both experts and users<sup>70</sup> generally agreed that clearly defined reporting duties promote additional disclosure of the auditor findings, addressing the concerns of, *inter alia*, the CESR (2007) and European Commission (2007; 2010b; 2010a) and IAASB (2012): that auditors are not reporting enough.

---

#### 4.4: SUMMARY

---

There appears to be only a limited impact on audit practice as a result of the operation of the RI provisions. Considering ISQC 1's emphasis on ethical business practice, including client acceptance and continuance decisions, many respondents reported that the RI provisions had little relevance, irrespective of the nature of the firm's clients or the size of the respective experts' audit firm. The same was true for engagement performance and human resource

---

<sup>70</sup> This should be read in light of this research's limitations and delimitations (Section 1.4.2).



practices with s45 of the APA altering neither the 'nuts and bolts of audit' (E9) nor the scope of the attest function. More significant for both experts and users was a belief in professional duty, professional appearance, and a sense of personal duty to the respective firm. This is not to say, however, that the RI provisions are irrelevant when thinking about audit quality.

Respondents were quick to note that the whistle-blowing duty led to enhanced reporting by auditors resolving a tension between owing a public duty to bring transgressions into the open and the need to ensure confidentiality of client information. In the context of on-going debates on the extent of information being made available to stakeholders (European Commission, 2010b; IAASB, 2012), these findings suggest that the RI provisions are one means of adding to the auditor reporting framework without necessitating a drastic change to existing audit practice by, for example, requiring auditors actively to seek out fraud. In addition, the RI provisions could contribute to safeguarding auditor independence. The prior literature points to a growing concern of independence failures detracting from the credibility of the attest function (Section 2.2; Section 2.3). Section 45 of the APA indirectly serves as an independence safeguard by offering a means of resisting client pressures to refrain from reporting even when reporting was perceived as being in the public interest. (This may be especially relevant for those auditors more economically dependent on their clients)<sup>71</sup>. Integral to this is the move to reduce the application of professional judgement by requiring any act of fraud to be reported, even if immaterial, and for whistle-blowing to take place 'without delay' (IRBA, 2006). At the extreme, this approach may save the profession from allegations of impropriety. Paradoxically, despite the presence of penalties for non-compliance, the RI provisions were interpreted as affording a measure of protection for auditors. The statutory provisions increase the likelihood of reporting transgressions by providing a formal reporting mechanism that clarifies when and how one ought to blow the whistle. Complementing this is the fact that it is an independent regulator, rather than the auditor, who decides whether or not an RI is brought to the attention of the relevant third parties, effectively adding additional 'layers of independence'.

Finally, although the RI provisions do not alter the scope of an audit it has the potential to complement traditional audit reporting, thereby reducing a perceived expectation gap concerning the scope and detail of information made available by auditors to stakeholders. By bringing issues that would otherwise have gone unreported to the attention of the IRBA, the whistle-blowing duty also contributes to corporate transparency and a culture of governance-

---

<sup>71</sup> This was one of the only instances when experts specifically felt that the RI provisions had more impact on smaller firms' quality standards.

related compliance (Chapter 7), benefits accentuated by more active reporting under the APA than was the case with the MI provisions (Section 2.1). In turn, this was cited as improving the perceived value of the attest function, simultaneously adding to the credibility of the audit profession (Section 6.1).

To explore the relevance of s45 of the APA in more detail, Chapter 5 uses a correspondence analysis to aggregate and complement the main arguments identified in this chapter. Before proceeding, a final note on the respondents' opinions is, however, necessary. In particular, there were no material instances when users and experts, in general, had significantly different views on the role of the RI provisions for adherence to sound quality control principles. This should not be interpreted as implying that s45 of the APA has resolved the long-standing expectations gap. Instead, the findings are consistent with the fact that users are well informed of the audit process. This is not a shortcoming. The aim of Chapter 4 was to shed light on the interconnection between the RI provisions and audit quality control systems and not to discern the extent of any expectation gap by surveying large groups of stakeholders. Similarly, this chapter has not presented a detailed discussion on the size of the audit firm as a quality surrogate.

Evaluating the appropriateness of firm size as a quality surrogate in a South African context is best suited to a more positivist study, relying on large sample sizes. Accordingly, further evaluation of the audit expectation gap and relationship between audit firm size and engagement quality, as discussed in 1.4.2, is deferred for future research (Section 8.3).

## 5: SECTION 45 OF THE APA AND ISQC 1: A CORRESPONDENCE ANALYSIS

---

This chapter presents the results of the correspondence analysis<sup>72</sup>. As discussed in Section 3.2.2, the final correspondence plot is used to aggregate perceptions on the association or correlation between quality elements (as defined by ISQC and discussed in detail in Section 2.2.4) and the RI provisions. Using principal component analysis, the views of a sample of experts were reduced to an easy-to-interpret two-dimensional plot (Figure 5.1). This plot is interpreted by the researcher to shed additional light on the role of s45 of the APA in South African audits. Effectively constituting a summary of the opinions of a sample of experts, the plot was also discussed during follow-up sessions<sup>73</sup>. It allowed experts and users an opportunity to reflect on the collective views of their peers and provide additional commentary on the perceived impact of the RI provisions on quality control systems (Section 3.4).

Figure 5.1 below neither ‘quantifies’ audit quality nor proves (in a positivist sense) that the RI provisions cause measurable change in audit quality. Instead, the correspondence analysis is used solely in an illustrative role (Section 3.2.2). Interpretive research is able to provide detailed accounts that are useful for examining relatively understudied aspects of corporate governance (Brennan and Solomon, 2008). A disadvantage of qualitative studies, however, is that added detail frequently goes hand-in-hand with technicality, detracting from the clarity of the study (Merchant, 2008; Creswell, 2009). In this context, a correspondence analysis is a useful technique for summarising major themes identified during the carrying out of detailed interviews both for the purpose of the clear communication of findings to readers and for use by the researcher when carrying out follow-up sessions with interviewees (Section 3.4).

The remainder of this Chapter is organised as follows: Section 5.1 presents the results of the correspondence analysis and briefly explains the derivation of Figure 5.1. Section 5.2 interprets the plot. As part of this process, the respondents’ opinions on the correspondence plot are

---

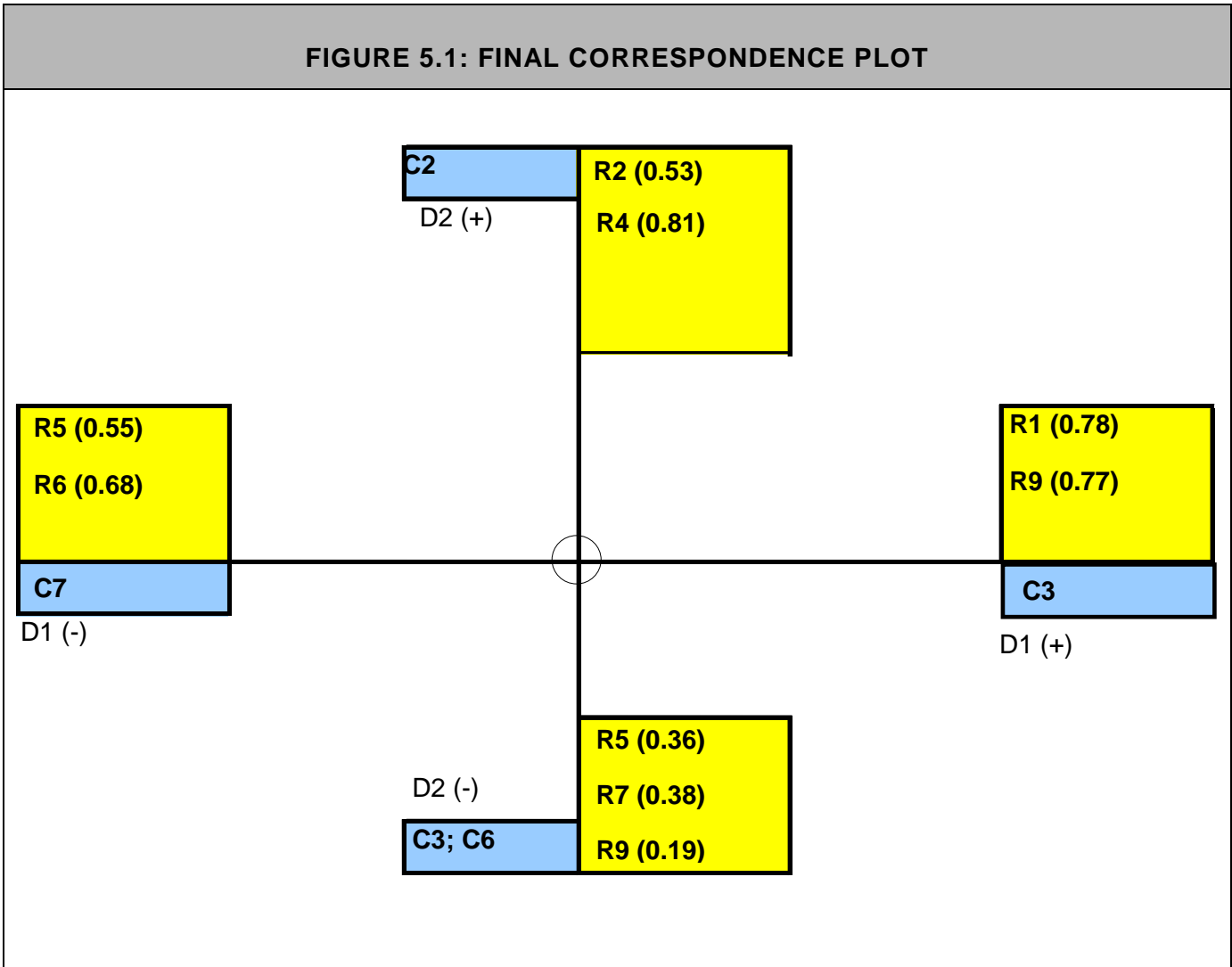
<sup>72</sup> Chapter 5 should be read in the light of the findings from Chapter 4. It should also be noted that, as the correspondence analysis is simply a complementary part of the thesis, this chapter is relatively short. It has been included in a separate chapter due to the use of a different method at the recommendation of participants from the Africa Leads Conference (2012) and King’s College London Doctoral Colloquium (2012).

<sup>73</sup> As the plot examines the operational aspects of ISQC 1 in detail, it was completed only by experts (Section 3.2.2) but was commented on by experts and users during follow-up sessions.

considered to add to the commentary in Chapter 4. Section 5.3 summarises results and introduces the need for an institutional perspective on audit quality.

5.1: THE CORRESPONDENCE PLOT

The bi-plot summarising the perceptions of experts on the association between the RI provisions and quality elements is presented in Figure 5.1 (Appendix C). As discussed in Section 3.4.2 only those row and column headings that contribute materially to the total inertia of the analysis are included in the plot (Section 3.4.2: Table 3.6; Table 3.7).



**FIGURE 5.1: FINAL CORRESPONDENCE PLOT**

Notes

1. Column headings (elements of the RI provisions) define the x- and y-axis and are shaded in blue.
2. Row headings (quality traits per ISQC 1) are plotted on the respective axis and are shaded in yellow. The squared correlation coefficient is quoted for each row-plot.

**TABLE 5.1: ROW AND COLUMN LABELS**

Axis labels (column headings)	
C2	Reporting to take place immediately vs. after 30 days under the PAAA
C3	Failure to report an RI could lead to liability and criminal sanction
C6	RI's include a material breach of trust and fiduciary duty
C7	RI's involve management only
Statements (row headings)	
R1	Development of a culture of leadership with more participation by the engagement leader
R2	Awareness of the importance of ethical compliance including client acceptance and continuance procedures
R4	Ensuring appropriate consultation on contentious matters and resolution of differences of opinion
R5	More attention paid to internal quality control and continuous improvement processes, including documentation standards
R6	Enhanced transparency and confidence in the audit process and increased perceived value for stakeholders (including improved reporting quality)
R7	Enhanced sustainability for audit firms, including reduction in overall audit risk
R9	A sense of personal responsibility for auditors and auditors being held to account

The RI provisions serve as columns (column-points) and audit quality elements (Section 2.2.4) constitute the rows (row-points) in the final correspondence table (Table 3.1). Using principal component analysis, row- and column-points are plotted in a two-dimensional space<sup>74</sup>. Based on the coordinates of each column point, its correlation coefficients and its inertial contribution (Table 3.7), the column points are 'assigned' to each dimension in the two-dimensional space, effectively defining the positive and negative x- and y-axes in Figure 5.1. Only the column points with a material inertial contribution have been included in Figure 5.1 to ensure ease of interpretation. Similarly, based using the sign of each row-point coordinate (as well as its correlation coefficient and inertia), row-points can be positioned in the two-dimensional space effectively depicting their association (or correlation) with each plot axis. Those row points with a material inertial contribution are included in Figure 5.1 according to which of the axes they have the strongest association with (adapted from Bendixen, 1996; Mimmack et al, 2001). The result is a two-dimensional plot that summarises the opinions of a sample of experts on the association between the RI provisions and audit quality elements.

Consistent with the approach followed by Bendixen (1996) and Maroun et al (2011), Figure 5.1 is used to focus on key relationships in an otherwise complex set of interconnected variables or traits (Section 3.2.2; Section 3.4.2). Figure 5.1 was then subject to initial interpretation by the researcher using the prior literature as a basis of analysis, consistent with most interpretive studies (see Humphrey, 2008; Creswell, 2009). Due to ease of interpretation, the plot was also used during follow-up sessions with interviewees, providing a basis for further discussion on the role of the RI provisions in South African audits.

---

## 5.2: DISCUSSION

---

Confirming the arguments raised in Section 4.1, the RI provisions have at least some relevance for an awareness of ethical concerns, including client acceptance and continuance decisions (R2). This is evidenced by the high correlation between the quality trait and the fact that, under s45 of the APA, RI's are reported 'without delay' (C2).

---

<sup>74</sup> This initial plot is presented in Appendix C. Figure 5.1 includes only the most relevant column and row points. Axes are labeled with column headings and the row points that corresponded with the respective column points are summarised.

'My first reaction is that "reporting without delay" is a bad thing. It puts pressure on the auditor and can damage client relationships. But, with hindsight, I can say that the when you had 30 days to report, that led to a lot of things being swept under the carpet. The legislation now crystallises the reporting requirement' (E2).

In addition to mitigating client pressures that may detract from active reporting (E2; U3), the fact that the auditor reports an RI to the IRBA 'without delay', rather than first discussing the matter with the client and reporting only if the RI went unremedied (Section 2.1), was cited by several users and experts as important for independence of appearance. In particular – and consistent with the arguments raised in Section 4.3.3 – 'reporting without delay' was especially relevant for the perceived effectiveness of audit reporting:

'Just having the reporting duty does not mean much'<sup>75</sup>. What's more relevant is that you have to report without delay. It's that particular change that makes partners more aware of the duty to report...and which gives people the confidence that things do get reported when they need to' (E13).

'So, what the correspondence table says to me is that immediate reporting has helped overcome the issue of auditors circumventing reporting which may have been the case with the old MI's. We now have more active reporting. Auditors are better at informing the IRBA about things and that improves governance in general. Faster reporting also stresses to clients that auditors have this duty and that the auditor is going to report RI's. This is significant for independence in both fact and appearance and I think that reporting without delay is adding to both' (E5).

The prior literature points to the possibility of economic dependence on the client eroding auditor independence and detracting from the quality of the audit report (IFAC, 2006; Blay and Geiger, 2013; Wines, 2012). What the correspondence plot and expert commentary imply is that reporting without delay per s45 of the APA partially mitigates this (Nel, 2001), addressing the concern that a lack of auditor independence resulted in historically low levels of MI's being reported (Section 2.1):

'What s45 [of the APA] does is create a quick reporting mechanism that compels the auditor to report. This resolves the problem of a sense of loyalty to the client and owing the client a duty of confidentiality' (E10).

'You are going to get a lot of pressure from the client and compliance with the legislation is going to come down to how independent you are – to how well you can resist those client pressures and serve the public interest' (E1).

---

<sup>75</sup> The general requirement for RI's to be reported to the IRBA (C1) had a low inertial contribution and was excluded from the plot.

'...Having to report quickly to the IRBA is an important part of this. It means that there is no time for uncertainty to set in and for the client to start working on changing the auditor's conclusion on having to report which may have been the case with the MI requirements' (U13).

'It also creates an escape hatch. You can justify reporting to the IRBA on the basis that the legislation compels you to do so. Without the duty to report RI's without delay, you may be divided. Do you report and risk losing the client or being sued or do you adhere to the old principle of client confidentiality?' (E3)

In effect, s45 of the APA formalises the requirement for auditors to blow the whistle on irregularities. Together with the regulator's guidelines (IRBA, 2006), the legislation defines both when and how the auditor ought to engage in whistle-blowing (E2; E4), thereby promoting more active reporting of improprieties (see also Reckers-Sauciuc and Lowe, 2010; Seifert et al, 2010). The result is an added sense of accountability and transparency on the part of the audit client and a contribution to culture of corporate governance compliance that resonates with the ideal of auditors serving as a 'watchdog' (Section 6.1). Complementing this is the fact that the RI provisions allow the auditor to rationalise the act of reporting to clients, allowing the auditor to overcome a duty of confidentiality or sense of client loyalty that might otherwise have stifled reporting, even if contrary to the public interest.

Concurrently, the accelerated reporting duty accentuates the risk of litigation for the auditor who, acting in good faith, erroneously reports an RI (IRBA, 2006; Maroun and Gowar, 2013). Coupled with a possible threat to reputation (E6; E9; E10); damage to the client relationships (E1; U10; E5); and the implication of a criminal sanction for non-compliance with the APA (C3), the RI provisions (C2) emphasise the relevance of auditor ethics (R2). This is complemented by a sharpened focus on consultation (R4); encouragement of engagement leader participation (R1) and a sense of personal responsibility and accountability (R9) as was found in Section 4.3 and Section 4.1.

'What [Figure 5.1] highlights is that you, as the partner, are responsible for the audit. It comes as no surprise that people are more inclined to consult and get more involved in the audit when they think there is an RI and that the partner feels personally responsible. It's a combination of the statutory duty, the consequences for messing it up, and the damage to your professional reputation. It's also because of the consequences for the client (of saying there is an RI when there isn't) and risk to the auditor if you get the report wrong' (E9).

'What makes it worse is that you can't take forever to decide if you are going to report. To be in line with the Act, you've got to report within a reasonable amount of time' (E10).



'So the end result is that...the legislation has made partners more aware of the role they need to play on the audit' (E1).

These comments are consistent with the correlation between consequences for not reporting (C3) and a sense of personal responsibility and accountability (R9) as well as the importance of effective leadership (R1). As theorised by, *inter alia*, Roberts (2006; 2009) and McMillan (2004), for at least some experts, the added reporting duty - backed by penalties - gives rise to an individualising effect. Further, the association between R9 and R1 respectively with C3 echoes the importance of being responsible for one's own reputation (E1; E5), the good name of the firm (E2; E4) and of the profession (E1; E2; E4), reminiscent of a type of moral or social duty on the part of individual partners, as discussed in Section 4.2.

Figure 5.1 also highlights a correlation between reporting requirements (C6; C7) and internal quality control (including continuous improvement and documentation standards) (R6) and a sense of enhanced transparency, confidence or value in the audit process (R6). Initially, these findings seem inconsistent with Section 4.3 which noted that engagement execution has not been materially impacted by the RI provisions. While R3 (addressing the resources of engagement teams) did have a low inertial contribution (Table 3.6), follow up-discussions provided further insight. In line with the opinions of most users (Section 4.3.3) the additional reporting requirement is seen by some experts as adding to corporate transparency. It also appears to bolster confidence in the audit process by providing at least some assurance that irregularities, if detected, are brought to the IRBA's attention (Chapter 7).

'What we have is an indication of how s45 of the APA may be about serving the public interest. The expectation of the public is that we act properly and that - being regulated - together with the position of trust that we hold, means that auditors don't hesitate to blow the whistle (E1).

'The RI's definitely add value. Whenever you bring shenanigans into the public domain, that's in the public interest. Knowing that this duty is there and that we do more than just comment on the financials reassures at least some people and probably adds to the overall image of auditors, even if just a little' (E10).

'In a way, the RI's are about whistle-blowing. There has been a lot of emphasis on that because of the value that it adds to corporate governance. RI's are part and parcel of that' (E3).

'With all of the criticism levelled at auditors over the recent years and the debates going on about what the audit report should look like, it's important that we have already been doing more than other auditors. We have been making a valuable contribution to corporate governance by blowing the whistle on RI's. This has added to our professional [standing] and the quality of the whole reporting exercise. I can't say that is a massive value-add but RI's have added something' (E2).

For whistle-blowing to be ‘value-adding’ (E2), reports issued to the IRBA need to be factually correct, necessitating sound quality control *in connection* with reporting (E3; E5). In other words, while the RI provisions do not alter standard audit practice (Section 4.3.2), firms take a number of measures to ensure that reporting to the IRBA is backed by sufficient evidence while remaining within the ambit of the ‘report without delay’ requirements of the APA<sup>76</sup> (E1; E6). Civil claims for incorrect reporting are part of the reason for this (Maroun and Gower, 2013). At a personal level, we see the need to preserve the good name of the profession (E6; E7), as well as individual and firm reputation. Also relevant is safeguarding the continued existence of the firm (R7) by mitigating exposure to risk associated with reporting RI’s (E3; E9). Accordingly, we see a correlation between the sustainability of audit firms, internal quality control (R5) and a sense of individual responsibility and accountability by partners (R9) in connection with the RI provisions (C3; C6; C7). An exception is the requirement to report fraud (C5). Further discussion with experts revealed that, while reporting fraud was an important part of s45 of the APA, most instances when partners had been required to report involved fairly inconsequential accounts. Experts noted that the legislation mandates reporting, irrespective of its perceived materiality (Appendix A1). They also explained that, in some cases, fraud – actually detected by the client and already remedied – was still reportable, in spite of its negligible impact for stakeholders. For this reason, few experts felt that this aspect of the APA had a material bearing on the row statements, a sentiment shared by most users.

---

### 5.3: SUMMARY

---

Ultimately, the results of the correspondence analysis provide additional insight into the relationship between the RI provisions and audit quality control systems. (The findings are also in line with those presented in Chapter 4.) The correspondence analysis should not, however, be construed as ‘quantifying’ the effect of the RI provisions on audit quality control systems in any positivist sense. Figure 5.1 should also not be misunderstood as ‘representing’ a consensus. For several experts, the RI provisions were cited as having little relevance for audit quality practices. This is seen in the fact that, while some quality elements may be correlated

---

<sup>76</sup> What experts are referring to is the ‘reasonable auditor test’ (IRBA, 2006). Under the APA the auditor may not report frivolously. He reports ‘without delay’ if a reasonable auditor, having gathered the necessary evidence to reach an informed conclusion that he ought to report, would have taken a comparable amount of time to send the 1<sup>st</sup> report to the IRBA (IRBA, 2006).

with certain elements of the RI provisions, the correlations are not perfect. Several of the quality elements also had low inertial contributions. For example R3 (resources and competency of engagement teams) was well correlated with requirement to report RI's concerning management (C7) but contributed less than 5% to the total inertia of the plot. Likewise, R8 (a sense of legitimacy) was fairly correlated with the positive x- (C3) and negative y-axis (C3; C6) but failed to weigh heavily on the minds of participants (inertia less than 5%). A lack of complete correlation between all elements of the RI provisions and quality traits should also be noted. As explained by several respondents, with the fundamentals of audit practice left unaltered, it was difficult always to associate the RI provisions with material improvements to audit quality control principles. For example, the auditor is not obligated to execute additional audit procedures and would, theoretically, detect no more or less than in the absence of regulatory requirement. It is only if the auditor happens upon an RI that a reporting duty is triggered. In addition, there is the risk of superfluous reporting or a simple compliance-based attitude towards whistle-blowing that detracts from the functionality of the RI provisions.

Paradoxically, however, respondents almost unanimously concluded that s45 of the APA should not be repealed<sup>77</sup>. That the reporting duty had been in place for several years; was codified in professional standards; and was enshrined in statute were among the reasons for it being retained. Initial commentary also suggested that the mere fact that this formal, rational whistle-blowing mechanism *exists* and that an independence safeguard is *theoretically* available was sufficient to justify its existence, especially from the point of users. Although, practically, audit remains the 'black box' described by Power (1994), the reporting duty complements notions of the 'independent auditor' (U9) creating images of the proverbial 'watchdog' (U3) sounding the alarm when transgressions are noted. In other words, the value of external regulation may be derived, not only from changes at the operational level which enhance efficiency or quality (see Meyer and Rowan, 1977), but from representations that reassure users of audit reports that belief in the attest function remains justifiable (see Unerman and O'Dwyer, 2004; Malsch and Gendron, 2011). This is especially true given the lengthening chorus for reform in the aftermath of recent audit scandals (Tremblay and Gendron, 2011) and ever more common use of external regulation in leading economies (Malsch and Gendron, 2011). In this context, Chapter 6 considers the RI provisions, not as an instrument for improving audit quality control systems, but as part of a complex institutional environment aimed at securing legitimacy for the attest function.

---

<sup>77</sup> The closing comment in Section 4.4 regarding differences in opinions between users and experts and among experts dependent on their firm-affiliation applies equally to Chapter 5.

## 6: SECTION 45 OF THE APA: PERCEPTIONS OF LEGITIMACY

---

In this chapter, findings from interviews with experts and users are presented in relation to the interviewees' perceptions of legitimacy. As discussed in Section 2.2 and Section 2.3, external regulation may be enacted with an aim to improving audit practice. Considering South Africa's RI provisions, Chapter 4 noted that, while some changes to perceived independence and reporting quality may have resulted from the mandatory duty to blow the whistle (Section 2.1), the 'nuts and bolts' (U2) of audit have not been fundamentally altered by s45 of the APA. Despite this, respondents unanimously agreed that the RI provisions formed an important part of the auditor regulatory paradigm. One reason for this apparent contradiction is that, although s45 of the APA may not yield material quality gains, it forms an integral part of processes of auditor legitimisation. This may be especially relevant in the context of a host of corporate scandals and an on-going financial crisis which Section 2.3 has argued has undermined the potential of self-regulation to offer material legitimacy benefits. In this context, the second research question is considered:

### ***B: Does s45 of the APA afford legitimacy to South African external audit?***

This section is organised as follows: Section 6.1 explores how the RI provisions may confer a sense of moral, pragmatic and cognitive legitimacy on the South African external auditor. This builds largely on Section 2.3 and the work of Meyer and Rowan (1977), DiMaggio and Powell (1983) and Suchman (1995). Section 6.2 offers a more critical perspective, highlighting the views of those respondents who point to the reporting duty being part of a carefully cultivated 'institutional myth' (Meyer and Rowan, 1977) that simply creates the impression of regulatory reform while leaving audit practice largely unaltered. Section 6.3 summarises the findings and introduces s45 of the APA through the lens of Foucauldian power and control.

## 6.1: PRAGMATIC, MORAL AND COGNITIVE LEGITIMACY

---

### 6.1.1: PRAGMATIC LEGITIMACY: AUDIT AS AN EXAMPLE OF WHISTLE-BLOWING<sup>78</sup>

---

As a means of adding to the information available to users, several respondents felt that the RI provisions added value for stakeholders, simultaneously recognising the need for auditors do to more than just issue generic audit reports. In this way, the reporting duty becomes an important source of pragmatic legitimacy:

'The big issue with audit has always been whether or not it adds value. For the big listed companies the theoretical argument is that audit does add value because the auditor reports to the shareholders on the reliability of the financial statements but...I guess for a lot of people...audit is really a grudge purchase. Adding RI's on top of that at least gives a bit more. I am not sure that significant value has been added but [the auditor] has at least added something' (U2).

As with Chapter 4, users noted that the legislation did not resolve the debate on whether or not the auditor has a duty to detect fraud and has not materially altered audit practice. What is, however, achieved is added 'depth' (E13; U7; U8; U9) to what is reported (Section 4.3), which is interpreted as improving transparency and being responsive to the information needs of varied user-groups (consider also Solomon, 2009; Solomon, 2010; Georgiou and Jack, 2011).

'At the end of the day, shareholders – and I suppose other people as well – have a right to know. If you have invested money in a company or are doing business with them or even if you just rely on that particular company, you have a right to know if there are any anomalies. That's one of the main themes coming out of the codes of governance and the whole integrated reporting project. Now what the RI's are doing is creating a duty on the auditor to do more than just issue a generic audit report. The legislature is taking cognizance of the needs of different parties to be made aware – through the functioning of the IRBA – of irregularities. So, in that way, s45 [of the APA] is

---

<sup>78</sup> Section 45 of the APA may be loosely described as an example of 'whistle-blowing' (Section 2.1). Whether or not the RI provisions are aligned with technical constructs of 'whistle-blowing' as advanced by Jubb (1999) and Near and Miceli (1984;1985) is not the focus of this research. What is more important is resulting connotations and perceptions associated with several respondents describing s45 of the APA as form of whistle-blowing.

basically a type of whistle-blowing platform that is responding to the demands for better audit reports and for enhanced transparency and accountability on the part of corporates' (U13).

'For example, you might go to a client where there is a delinquent board of directors and material breach of fiduciary duty. It might also happen that the financial statements are prepared mainly by the financial accountant and the financial statements are accurate. In that case, the audit opinion is clean. But stakeholders have a right to know that the board of directors is delinquent...the auditor...cannot blow the whistle [because of the duty of confidentiality] but through the guise of the RI's, he is able to get this information to the regulator and hence to the public' (U7).

'Section 45 [of the APA] may not be perfect... [but], there is at least a perception that the auditor has a duty to report... And it's not limited to just financial statements'<sup>79</sup> (U2).

The RI provisions' legitimising potential is derived from the production of reports offering specific details on irregularities that would otherwise not have been in the respective regulatory or public domain. This was cited as especially relevant given the recent criticisms of audit reports lacking sufficient 'depth' (U2). The whistle-blowing duty found in s45 of the APA, by virtue of its *potential* to bring transgressions into the open is perceived as positively contributing to existing corporate governance systems. The RI provisions effectively constitute a type of 'whistle-blowing discourse' (E16), which forms part of a broader social milieu where almost all respondents pointed to enhanced reporting as a favourable requirement. In other words, the whistle-blowing duty reflects normative values and perceived social interests that associate the act of reporting with enhanced transparency and accountability (U2; U12; E16), improved financial reporting (E9; E17; U13), a sense of value for stakeholders, and ultimately exchange legitimacy<sup>80</sup> (see Khalifa et al, 2007; Georgiou and Jack, 2011). For example, RI's could, depending on their nature, be useful for the JSE in monitoring compliance with its listing requirements and, thus, protecting investors (U3; E7). They could also be used by both the taxation and company regulatory authorities to monitor and enforce compliance with respective legislation (U5; E10). More generally, respondents cited the whistle-blowing duty as contributing to a culture of compliance with existing governance standards and a sense of accountability on the part of audit clients that ultimately serve the public interest. The result of a perceived responsiveness to the interests of stakeholders, coupled with an added sense of value derived

---

<sup>79</sup> That s45 of the APA may amount to little more than imagery or perception management is discussed in more detail below.

<sup>80</sup> By way of example, consider Georgiou and Jack's (2011) account of fair value accounting practices. The researchers argue that fair value accounting practices incorporated in certain IFRS 'link with current discourses of shareholder and economic value' and, thus, become a source of pragmatic legitimacy. Also relevant are the findings of Near and Miceli (1995), Hwang et al (2008), PwC (2011b) and KPMG (2011) which highlight an association between whistle-blowing, sustainability and improved value for stakeholders through gains in transparency (Vinten, 2000; Seifert et al, 2010).

from additional disclosure, gives rise to notions of pragmatic legitimacy. This is especially true given that the RI provisions entrench a reporting duty for auditors at a time when the adequacy of generic audit reports is under question (European Commission, 2010b; IAASB, 2012).

Although some experts highlighted the possibility of the RI provisions leading to over-reporting because of the duty to report any act of fraud and other defined irregularities 'without delay' (Section 4.3; Section 2.1), that the legislation favours prompt reporting, and that only a fraction of RI's may be highly relevant, was perceived as having confirmatory value and, thus, being a source of exchange legitimacy. In addition:

'Far better to leave the legislation as is and have a hundred minor issues get reported with just one big one than to tone [the reporting duty] down and run the risk that the next significant issue does not get reported' (E16).

'[Broadening the reporting duty] lets the clients know that things get reported, even if otherwise immaterial, and that definitely keeps them on their toes... and [that] almost pushes [audit clients] to do a little bit more because they do not want to get themselves in trouble - they don't want an RI to be reported' (U2).

'And finally, just remember that because *you* think something is immaterial does not mean that other people will. You set a precedent by doing that and before long, who knows what ends up not being reported' (E17).

'The marginal benefits of the legislation are, therefore, probably exceeding the marginal costs' (U2). By erring on the side of prudence, and requiring more active whistle-blowing (Nel, 2001), the legislation was perceived as adding to a culture of reporting and addressing the risk that the professional judgement of the auditor could lead to an irregularity, significant from the perspective of different stakeholders, going unreported (E14; E17; U2; U10).

'I think that there was a gap in [the sense that] if you have done an audit, and there was a problem on the audit, there wasn't necessarily any specific way that you could report this other than to shareholders<sup>81</sup>. So, I think that the [RI provisions] addressed [this]' (U7).

'There is a hell of a lot of judgement. What one auditor [decides to qualify his report for], another auditor may not necessarily have done. So, there will always be different interpretations. The audit report is also generic and doesn't always report things - like things that got fixed. Maybe shareholders would like to know about that, but it does not get reported because the audit report is...very much like a template. Consider a situation where tax has not been paid. Even if this is

---

<sup>81</sup> Due to the duty of confidentiality (IFAC, 2006), irregularities would be disclosed internally to those charged with the client's governance (IAASB, 2009j). In the absence of s45 of the APA, irregularities would be made public only if they had a material effect on the financial statements and, thus, resulted in a modification of the audit report (IAASB, 2009t).

sitting in the audit report – and there is no guarantee that it is – that would probably just go to a select [number] of people. The audit report does not necessarily go the [relevant] regulator. So, you might, for example, have a trust with donor money that has gone missing. That audit report may not necessarily go to the donor. [With the RI provisions auditors] at least now we have an independent and external way of reporting these problems’ (U7).

In other words, several respondents felt that the RI provisions took cognisance of the needs of diverse stakeholder groups, each of whom may have different views on the value of what is reported and on what ought to be reportable in the first place. With the audit report being relatively generic (U7; E1) and not necessarily available to all interested parties, s45 of the APA becomes an important whistle-blowing mechanism that adds to the pragmatic legitimacy of the attest function in the eyes of several respondents.

That the RI provisions are formalised adds to the sense of exchange and influence legitimacy by achieving an ‘ordered’ (E9) and ‘rational’ (U2) approach for discharging the whistle-blowing duty. The APA defines ‘irregularities’ and prescribes the reporting process, complemented by additional formal guidance made available by the IRBA (2006). The result is that users feel that the reporting duty is a *bona fide* one, allowing the auditor to add real value by enhancing the quality of what is reported (U12; U13). The legislation, coupled with the IRBA’s (2006) guide on RI’s, was cited as providing ‘added certainty on when and how to report’ (U12), highlighting that the reporting requirement was ‘capable of practical implementation’ and, accordingly, was also a means of adding to the ‘credibility’ or ‘reporting value’ of the audit process (U13). This is bolstered by the RI provisions serving as an independence safeguard as discussed in Chapter 4:

‘The reality is that in any business, you’ve got relationships with your different stakeholders. One of those relationships is with your customer. Now...what you try to do all the time... is protect that relationship. You need to make sure that that relationship is protected, whatever the cost, right? Now, we’ve got a set of regulations that require us to do something which is quite *unnatural* in the normal business relationship. In a normal business relationship, where you find that there is something which is wrong, you go and speak to the customer and [come up] with some sort of agreement and you sort it out. Now this is not the case. However, our job is [to be the] auditors and the basis of everything that we do is ethics. So what the legislation has done is that it’s made us more aware of what “ethics” means and what it means “to be ethical”’ (E3).

‘By creating a duty to report certain client transgressions, s45 of the APA drives home the duty of the auditor to ‘serve as a watchdog’ (U2) and, coupled with that,’ the importance of independence of fact and appearance’ (U12).



'When they found something wrong, [auditors] wanted to know how to report it without effectively "ratting out the client".... when I am obliged to [report] at least I can say I was forced into it. So the legislation is a nice "escape valve"' (U1).

'To a large extent, I think auditors were getting talked out of [reporting MI's]. They were getting an enormous amount of pressure from clients....If you go to the client first [with a suspected MI] they will probably talk [the auditor] out of [reporting] it...Now, the minute [the auditors] pick up [an RI] - and obviously the auditor is going to have to be reasonable and ask one or two questions – now the auditor has to report. And, I suppose that that protects the auditor as well, because if the client comes along and says: "look, this is our interpretation", the auditor can still speak to the client and do the investigations...but overcoming the first hurdle of actually reporting to [the IRBA] is already behind the auditor...What the legislation does is [therefore] help the auditor. It protects him by giving him a legal duty to report to overcome client pressures. It encourages reporting rather than potentially sweeping things under the carpet' (U7).

Although not all respondents shared these views, most agreed that, at the very least, the RI provisions can aid in resolving a tension between owing a professional duty of confidentiality to the client and being obliged to serve the public interest by bringing potentially material transgressions into the open. Related to this, the RI provisions provide a means of justifying reporting a client's transgressions to third parties:

'If the client comes back [after reporting to the IRBA] and asks: "How can you do this to us", the auditor can refer them to the statutory requirement and also the engagement letter<sup>82</sup>. The client must know, upfront, that if there are any problems and the auditor picks them up, the he is going to report it' (U7).

For users, this has provided further evidence that the reporting duty is a viable one, able to improve the scope and value of the audit process and, hence, its pragmatic legitimacy. Concurrently, several users felt that necessitating that *any* act of fraud be reported 'without delay', addressed the concern that heuristics (Ashton, 1992; Owhoso and Weickgenannt, 2009), self-interest threats or pressure from clients (Wyatt, 2004; Windsor and Warming-Rasmussen, 2009; SAICA, 2012) could lead to auditors avoiding reporting even if contrary to the public interest. Favouring broad reporting was thus seen as a type of preventive measure to safeguard effective whistle-blowing, reinforcing respondents' notions of a policy in line with broader

---

<sup>82</sup> ISA require the auditor to agree to the terms of an audit engagement with those charged with the client's governance in order to establish preconditions for the audit, the nature and scope of the services rendered and the responsibilities of the parties (IAASB, 2009d). In a South African context, the duties of the auditor under s45 of the APA would be explained in the terms of engagement (SAICA, 2007; IAASB, 2009d).

interests of diverse stakeholder groups (E17; U12)<sup>83</sup>. Complementing this is the move to couch the whistle-blowing duty in legislation, rather than as a professional requirement, which signals an awareness of constituents' concerns with the traditional self-regulatory model (E4, E8, E17).

'The whole concept of self-regulation I never quite understood because you end up with a situation where people just get together and form these rules which they can easily amend now and again when they feel like it. I don't think that that is necessarily the right answer. I think we need to strike a balance between self-regulation and demonstrating a commitment to users of the audit reports. On top of that, I think it's nice to have a separate body which we report [RI's] to because when you get difficult questions that you need to answer, you need somebody who is independent - who is going to be out of the situation - making a decision. So for that reason, I think it is good that we have an independent body' (E3).

'That not only assists with resolving technical difficulties with regards to s45 [of the APA] and with ensuring that conclusions are both in line with the legislation and not affected by relationships between the auditor and the client. It also shows users that we have been listening. After Enron and everything else that has been going on, people want auditors to be more regulated and to defer some of the difficult decisions to an independent regulator. By following these requirements, we are demonstrating that we don't just put our heads in the sand and hope people will think better of audit in the future. We now have the IRBA, which is much more independent of the profession than the PAAB was, that is involved in deciding what issues auditors have reported get escalated to the relevant people' (E17).

In this case, authority under a traditional self-regulatory approach (Odendaal and De Jager, 2008) is partially relinquished to regulation under the banner of the independent IRBA. Complying with s45 of the APA, signals the continuing commitment to secure the confidence of stakeholders, including clients (E1; E3). In other words, by adopting a type of conformist strategy (Meyer and Rowan, 1977; Suchman, 1995), whereby auditors are seen to comply with the RI provisions - regarded by constituents as a means of enhancing the financial reporting process (U12; E6) - a sense of legitimacy results<sup>84</sup>. Integral to this is the need to meet expectations of ever more powerful stakeholders:

'I think you need to have the reporting requirement because the market clearly wanted to have something in place' (E3) and 'at the end of the day, [when talking about blowing the whistle] that is the purpose of the auditor...Shareholders are looking to you to play a certain role' (E7).

---

<sup>83</sup> Although respondents did not cite specific examples of how whistle-blowing is practically able to add value for constituents, what may be important to achieve pragmatic legitimacy is the absence of negative experiences rather than 'the presence of positive achievements' (Georgiou and Jack, 2011, p. 321).

<sup>84</sup> Compliance with the RI provisions may also signal the entrenchment of a legalistic culture or emerging attitude of self-preservation (McMillan, 2004; Roberts, 2009) as discussed in Chapter 7.

Accordingly, the findings of Chapter 4, together with references by experts to maintaining professional standards (E4; E5; E10); the good name of the profession (E4; E7); the image of the firm (E5; E9); and the trust of shareholders (E5; E8; E12) highlights an awareness of the importance of auditor legitimacy. Although sanctions under the APA probably serve as a deterrent (E5; E11; U1; U7) also relevant is conforming with the expectation that the auditor 'is a watchdog' (U2), allowing the auditor to internalise pragmatic legitimacy associated with the RI provisions.

'I think you need to have the reporting requirement because the market clearly wanted to have something in place' (E3).

'I don't think that [auditors] would wilfully [circumvent their reporting duty]. I don't think that that occurs to them. The IRBA would never know but there is a general risk from outsiders' (U1). 'They have a piece of legislation that tells them what society expects and they seem to be aware of the importance, as professionals in whom we place our confidence, of meeting these expectations - of conforming with society's regulations and, hence, its desires' (U13).

'If [the failure to comply with the whistle-blowing duty] gets out, that auditor is finished' (E3). 'Yes, they *might* get sued by someone but whether that happens or not, he did not live up to expectations and he has zero chance of being trusted. That auditor has lost all credibility. He has *zero* standing because he has ignored the duty he owes to people other than himself' (E16).

With the whistle-blowing duty regarded as a valuable part of the corporate governance paradigm, and synonymous with pragmatic legitimacy, audit firms are implicitly encouraged to comply with the RI provisions to win favour and secure their credibility. This is especially the case given current trends favouring more extensive disclosure of audit findings<sup>85</sup> (consider Nel, 2001; Manuel, 2002; European Commission, 2010b). In other words, conformance with the reporting duty is a means of meeting users' expectations; of signalling professional behaviour, trustworthiness and value-adding conduct; and hence adding to perceptions of pragmatic legitimacy. Respondents, therefore, confirm the findings of Suchman (1995, p. 587): to achieve pragmatic legitimacy, the perceived needs of constituencies must be met.

---

<sup>85</sup> That this may also signal the operation of processes of mimetic isomorphism (DiMaggio and Powell, 1983) and further contribute to the perceived legitimacy of the South African audit profession is discussed in more detail below.

---

### 6.1.2: WHISTLE-BLOWING GIVING RISE TO MORAL LEGITIMACY

---

There may be more to whistle-blowing by external auditors than simply material benefits for constituents. For most interviewees, the RI provisions echoed a need to ensure enhanced levels of transparency and attitude of compliance that quickly translated into the RI provisions being seen as an accountability mechanism that resonates with the value systems of users:

'I think whistle-blowing is very important...Generally, any responsible citizen has got a duty to flag something that they think is wrong...and if you don't have that in society, then morally, things begin to degenerate. [That means that] any person in a company set-up has got a moral duty to report [irregularities]' (U2).

'I think that people have a *right* to know what is going on and to make their own minds up' (U3).

'We can also take [the RI provisions] to a moral type of duty [sic]. There are certain cases where the auditor should be airing the dirty laundry because of the public perception of the auditor as a watchdog' (E10).

Whistle-blowing becomes part of a sound corporate governance culture and a type of moral imperative in the name of transparency<sup>86</sup> (U2; U9; U6) and serving the public interest (U2; U5; U13). The RI provisions are no exception with past scandals, whether in South Africa or abroad, offered as examples of how s45 of the APA can contribute to local governance standards, 'improved transparency' and 'social good' (U2; U10; E9; E11). Reinforcing this is the position that certain stakeholders have a 'right' to expect enhanced reporting:

'Because auditors have been awarded a protected industry, and because the role they play as a type of control over companies is not challenged, the [RI provisions]... are a type of payback. So the legislation says that every company has to have an audit and now, because of that, you have to report when things have not happened properly....It's a way of showing that [the audit profession] take society's confidence in [it] seriously; that [it] give[s] something back; and that [its] protected position is justified' (U10).

'And maybe we hold the auditor to a higher standard. We do that, don't we? And that's because the auditor is a watchdog. We expect them to report because of their role and position' (U3).

---

<sup>86</sup> In dealing with 'moral legitimacy' the aim is not to explore every angle of the term. Examination of philosophical or alternate social theories for s45 of the APA is, therefore, deferred for future research (Section 1.4.2). What is relevant for the purpose of this research is simply that some respondents regarded the RI provisions as socially acceptable and a possible moral imperative. What is important to note is that whistle-blowing is a social act with the result that reporting irregularities is interpreted subjectively (Hwang et al, 2008; Seifert et al, 2010).

Audit has come to occupy an almost 'revered' position in society culminating in a monopoly over the financial assurance market (Humphrey and Moizer, 1990; Power, 1994). What interviewees referred to is a type of *quid pro quo*: that in exchange for this position of trust and confidence, conceding to additional reporting duties under the APA becomes a means of signalling a commitment to broader societal welfare. It shows that the audit profession acknowledges its collective societal responsibility, an act intertwined with notions of moral legitimacy<sup>87</sup> (see also Suchman, 1995). This goes hand-in-hand with the view that auditors being obligated to report certain client transgressions without delay and irrespective of materiality is 'wise' (E17; U3), 'prudent' (U1; U13), 'empathetic' (U4), and 'accepting' (U1; U10) of the role that auditors 'ought to play in reporting transgressions' (E17). Similar sentiments were expressed by some respondents on the need to 'report without delay' rather than relying on the 30-day window period. Reiterating the arguments raised in Section 4.3, respondents felt that each of these provisions of the whistle-blowing duty entrenched a culture of accountability and transparency. In each instance, 'wisdom', 'openness', 'prudence', 'credibility' and 'empathy', examples of dispositional attributes (Suchman, 1995), leads to positive evaluations of the act of reporting by audit firms and, thus, affords at least some measure of 'personified' legitimacy (E3; U2).

Adding to this thinking is procedural rigour, particularly the fact that the reporting duty is enshrined in statute. Legal requirements effectively constitute rational, generally accepted methodologies or prescriptions strengthened by due process that 'back' the respective policy (Meyer and Rowan, 1977; Suchman, 1995; Power, 2003). The RI provisions may, therefore, confer on auditors a measure of legitimacy, not only by virtue of aligning audit with acts of whistle-blowing perceived as morally and socially appropriate (U2; U12). The requirement to blow the whistle may partially confer legitimacy precisely because it has been formalised in statute<sup>88</sup> (E1; E5; E15). Users, for instance, reported that the fact that the reporting duty was a legal, rather than simply a professional one, enhanced its perceived worth. Whistle-blowing requirements were described as 'crystalised' (U1) and not subject to the changing whims of the profession (E3; E7; E16) which almost all users felt reinforced notions of moral standing. Similarly, the need to send formal reports to the IRBA, coupled with 'layers of independence' (E6) in terms of which final decisions to escalate reports rest with the regulator rather than the

---

<sup>87</sup> This view was not unique to users. Several experts raised similar points.

<sup>88</sup> Georgiou and Jack (2011), for instance, argue that judicial process and legal mandate are possible sources of moral and cognitive legitimacy for early accounting practices (see also Sikka et al, 1998; Edwards, 2001). Similar processes seem to be at work with the RI provisions.

auditor, demonstrated 'procedural rigour' and 'objectivity' (E17; U7; U10; U11). As theorised by Suchman (1995), users reported that clearly defined legal protocols enhanced the perceived value of the reporting duty (influential and exchange legitimacy) as well as the conviction that, on average, the reporting duty is consistent with various stakeholder interests.

Strengthening specific reporting procedures is the fact that the auditor is 'perfectly placed' to discharge those duties (U2). The technical expertise of the audit firm, coupled with its commitment to ethical standards and professional duty (E1; E2; E8; E9), reinforces the practical ability of the auditor to blow the whistle on the client when required by the legislation, as discussed in Chapter 4 and Chapter 5 (E3; U2). In the absence of this practical ability, it would be doubtful that sustained consequential and pragmatic legitimacy could result. Just as Suchman (1995, p. 581), asks: does the manufacturing concern have a quality control department to support the claim to structural legitimacy, the fact that the auditor has the necessary resources at his disposal, including access to the client, has a similar effect. Stakeholders,

'can believe in the consequential effects of whistle-blowing, because it is conceivable that the auditor can comply with the reporting duty allowing the act of reporting transgressions to afford a sense of legitimacy' (U13).

Brand awareness, risk of litigation, a sense of professional commitment and internally held values and beliefs complement this. Each 'element' forms an integral part of the audit quality framework, discussed in Chapter 4, and, in the context of structural legitimacy, reassures users of the practicality of the auditor's reporting duty and propensity for whistle-blowing. This is particularly important for securing trust in the 'black box' (Power, 1994) that is the audit process:

'So, how do we know if the auditor finds an RI, he really reports it and doesn't just ignore it? I don't think that that is very likely because of the very nature of auditing. The auditor would, in effect, be putting his personal position at risk...not only because of the financial consequences but the clear reputational and professional consequences as well. So the stakes are too high and this is not just about the money or possibly going to jail. The stakes are high because [the consequences of not reporting] are so personal and so inconsistent with the very nature of the audit firms' (U1). In other words, 'the ramifications are so severe...that I don't think we need to be worried [about the auditor]...sweeping [irregularities] under the carpet' (U3).

'From a practical point of view, we are well placed. We have the integrity and the resources and the reporting duty ties in with what we do as part of an audit anyway' (E8) and 'at the end of the day, we have a professional and moral obligation to tackle irregularities appropriately as part of the professional standards, our commitment to the brand, and for yourself, as a professional

accountant' (E5). 'You don't just study seven years and work your arse off to become a partner at a respectable audit firm to just forget about these duties' (E7).

In this way, procedural, structural and consequential legitimacy are interconnected (Suchman, 1995). That the South African auditor's duty to report is enshrined in law; that the auditor is practically capable of discharging the duty; that there are ramifications for not complying; and that users feel that the reporting requirement is the 'right thing to do' (U3), leads to the conclusion by most users that the RI provisions result in a socially desirable output<sup>89</sup>:

'While s45 of the APA does not change audit on the ground, it is definitely in the public interest. Whenever you bring in an additional requirement to report companies to keep them honest....that is certainly in the public interest; it is certainly the moral thing to do; and it is definitely an important means of conferring legitimacy on the audit profession' (U2) .

'In a way, s45 of the APA gives users a sense of comfort and formalises a willingness by the profession to blow the whistle' (E1). 'It is a demonstrable commitment to meeting market expectations and the expectations of users that, when an irregularity is found, there is at least a formal process for bringing this into the public domain' (E13).

'So, in conclusion, I think that it [complying with s45 of the APA] is the right thing to do and does offer the audit profession a sense of moral standing or legitimacy - definitely' (E8).

What should also be noted is that the same outcome which is being perceived as morally legitimate is also (as discussed in Section 4.1) associated with being in the self-interest of different constituencies and, thus, a source of pragmatic legitimacy. This is not a contradiction. In a complex social setting, both forms of legitimacy often coexist (Suchman, 1995; Georgiou and Jack, 2011; O'Dwyer et al, 2011). A key difference, however, is that moral legitimacy does not depend on the perceived self-interest or utility of whistle-blowing but is rather a product of social and cultural evaluations leading to a favourable, but still normative, view of whistle-blowing, under s45 of the APA (Suchman, 1995).

---

<sup>89</sup> These comments, together with the findings in Section 5.2, should be also be seen in the context of the prior literature on whistle-blowing (Hwang et al, 2008; Reckers-Sauciuc and Lowe, 2010) and the financial press (ICSA, 2011; KPMG, 2011; PwC, 2011b) which highlight the conviction that whistle-blowing is pro-social in nature (Staub, 1978) and morally and socially justifiable (U12; E16; U2). The RI provisions are an extension of this, capitalising on the moral 'acceptability' of whistle-blowing and expanding it into the auditor's domain. Concurrently, laws and public opinion make it desirable for auditors to adhere to the whistle-blowing duty, gaining moral legitimacy in the process (consider Meyer and Rowan, 1977; Suchman, 1995).

---

### 6.1.3: ON THE ROAD TO COGNITIVE LEGITIMACY

---

Virtually all respondents accepted the act of reporting irregularities as a logical part of the South African corporate governance landscape. The duty for auditors to report under s45 of the APA is akin to a 'watchdog' (U2; E9; E14), a readily comprehensible part of daily life, and with whistle-blowing which is increasingly accepted as a 'natural' part of the corporate governance machinery (IOD, 2009; PwC, 2009; Solomon, 2009; Solomon, 2010; PwC, 2011b). In other words, a sense of innate comprehensibility complements the mutual reinforcing 'taken-for-granted-ness' of audit and whistle-blowing (Suchman, 1995; Llewelyn, 2003) as seen in the following:

'Why do you want to talk about s45 of the APA and whistle-blowing? Surely that stuff is obvious? The auditor has the duty to report RI's to the IRBA – it's part and parcel of what the auditor does. It's both a logical and inevitable part of corporate governance in South Africa. Whistle-blowing is to corporate governance what debits and credits are to accountancy' (E17).

Although blowing the whistle is not be the primary objective of an audit (IRBA, 2006; PwC, 2006), the reporting duty has been generally accepted – as part of the broader accountability and transparency paradigm – by several respondents as a logical part of local audit practice. To paraphrase Suchman (1995, p. 582), with the role of whistle-blowing 'meshed' with the larger belief system or accepted reality of stakeholders' daily lives (consider Crotty, 2007; PwC, 2011b; PwC, 2011a; King, 2012), the RI provisions achieve a sense of legitimacy based on comprehensibility and the assumption that s45 of the APA is a technical rational means of serving the public interest (Nel, 2001; Opperman, 2009). A comparable outcome was achieved by Robert Noyce, founder of Intel, who was able to draw analogies between paper clips – a common office consumable – and the utility of then-theorised microprocessor which would have enormous potential despite its small size (Rogers and Larsen, 1984 cited in Suchman, 1995, p. 582). From the perspective of external audit, the auditor was originally able to garner public trust by drawing parallels between the practitioner and the Victorian ideals of the 'gentleman' who was above working for a wage and always acted appropriately (Edwards, 2001; McMillan, 2004). When it then comes to auditors reporting under s45 of the APA, the duty is juxtaposed with a 'watchdog', a readily comprehensible part of daily life, and with whistle-blowing which is increasingly accepted as an inevitable part of the corporate governance machinery.



Legitimacy resulting from 'comprehensibility' can also be achieved by mimetic isomorphism (Meyer and Rowan, 1977; Suchman, 1995). Several interviewees felt that the appropriateness of and logic behind the whistle-blowing duty was reinforced by the fact that s45 of the APA forms part of the move towards more arms-length control of the profession in line with developments in other jurisdictions:

'With the increased fraud, and Enron and everything else that was happening, it was necessary to change. To an extent, this was a response to changes overseas but it was also about addressing shareholders' concerns and reassuring them that when [RI's are detected] they get reported' (E7).

'We need to strike a balance between self-regulation and legal requirements. You can't cater for everyone but I don't think that it would have been wise to just continue the way we were with regulations coming only from within the profession' (E3).

'For a very long time, the audit and accounting professions in South Africa regulated themselves. I think that there was a conscious decision to move away from a system of self-regulation to follow the trend in the rest of the world which relies on laws backed by penalties' (U2).

In this light, the 'whole Enron-SOX mess definitely had ripple effects for South Africa' (U1) with the result that it would have been unwise for the South African Government to fail to consider regulatory developments abroad for fear of being perceived as ineffective (U1; U4). This is not because the RI provisions resulted in a paradigm shift in the way audits are executed (Chapter 4) but because they signal a reaction to emerging challenges from abroad that may have begun to undermine the effectiveness of the self-regulatory ethos as the traditional source of auditor legitimacy. Based on DiMaggio and Powell's (1983) model of mimetic isomorphism, replicating, at least in part, the move to more arms-length regulation taking hold in developed economies (Canada et al, 2008; European Commission, 2010b; Bazerman and Moore, 2011) becomes a powerful means of securing the legitimacy of the South African audit profession.

As summarised by Konar et al (2003, p. 28), when it comes to the legitimacy of the South African capital market system, including the audit process, 'it is important that South Africa be seen to be in step with international developments regarding corporate governance'. In both the European Community and the USA, for instance, there is a conscious move towards additional regulation following a host of well documented corporate failures (E17; U7) (see also Nel, 2001; Unerman and O'Dwyer, 2004; Tremblay and Gendron, 2011). In South Africa, a similar *modus* is at work. The country, *inter alia*, refines its codes of corporate governance (IOD, 2009; Solomon, 2010); begins work on a new Companies Act, which includes certain mandatory auditor independence provisions (Konar et al, 2003) and, as discussed in Section 2.1, entrenches a

mandatory reporting duty for external auditors (Nel, 2001). What these developments highlight is how, in the aftermath of Enron et al, 'it is necessary for the [South African] Government to be seen to be taking action to assist in the restoration of public confidence and trust in financial reporting and auditing' by more actively regulating the audit profession (Konar et al, 2003, p. 69). At the same time, by achieving a sense of parity with regulatory developments in other jurisdictions, s45 of the APA inspires confidence rooted in the fact that South Africa has not simply maintained a self-regulatory status quo while, internationally, external regulation is championed<sup>90</sup>.

As a result, almost all users and experts pointed to the fact that formalising the duty to blow the whistle when MI's were replaced with RI's; broadening the reporting duties; clarifying that the RI provisions are under official control of an *independent* regulator; and reminding constituents of the existence of this legal duty capitalises on a sense of mimetic isomorphism that fortifies the sense of comprehensibility and generally accepted 'correctness' of the auditor's duties. Complementing this is the fact that RI provisions have been indirectly endorsed by external assessment criteria (U2; E8; E9). The 'appropriateness' and 'plausibility' of the reporting duty is justified by South Africa's audit and accounting practices having been independently ranked first on the international stage (IRBA, 2010b; IRBA, 2012c). These 'ceremonial' tokens of worth enhance the meaning of an act or organisation and reinforce its presumed appropriateness. They confirm that it is based on the latest thinking or is a respected 'first of its kind, adding to perceived credibility (Meyer and Rowan, 1977, p. 350-351).

Isomorphism, formalisation of the whistle-blowing process and its control by an independent regulator are a relatively subtle means of achieving legitimacy for the audit profession. Unlike a direct link between audit and utility for constituents or between audit and the morally sound action of blowing the whistle, the preceding techniques appeal to common knowledge, taken for granted 'truths' and the belief in formalised processes (Meyer and Rowan, 1977; Suchman, 1995). Ironically, the very power of cognitive legitimacy is that it is rooted in the abstract (Suchman, 1995).

---

<sup>90</sup> Fogarty (1992) provides an interesting analogy to clarify this point. He argues that an employing organisation is the most important environment for a professional's career. As a result, the professional has an incentive to behave in a fashion that is consistent with the organization's culture, expectations and norms (Rodrigues and Craig, 2007). By analogy, as a developing economy, South Africa has incentives to ensure that regulation of the audit system appears in line with a move towards more exogenous control over the audit community (Nel, 2001; Konar, 2003). What both examples confirm is that processes of isomorphism are powerful means of securing a growing sense of cognitive legitimacy as postulated by Meyer and Rowan (1977), DiMaggio and Powel (1983) and Suchman (1995).

## 6.2: A CRITICAL EVALUATION OF THE AUDITOR'S WHISTLE-BLOWING DUTY

---

Respondents agreed that, theoretically, compliance with s45 of the APA is not technically onerous. The audit firms are under no obligation actively to seek out an RI (IRBA, 2006) and, as discussed in Chapter 4, the reporting duty has not resulted in a material change to engagement practice. For these reasons, the RI provisions have not materially contributed to the transparency of the audit process. Related to this, and as discussed previously, there is no effort to establish a fraud detection duty for the South African auditor, implying that the RI provisions would not practically address a material perceived expectation gap (see, for example, Humphrey et al, 1993a; Sikka et al, 1998; Porter et al, 2012). There is also no generally accepted means of demonstrating that the whistle-blowing duty has actually generated actual gains for stakeholders and ultimately served the public interest<sup>91</sup>. Nevertheless, the act of preparing a report to an independent regulator was perceived by most respondents as a source of legitimacy for the audit profession. This begs the question: why are the legitimacy demands not more stringent? Why is it that simply preparing a report not more than a few pages in length (Appendix A6-A8) may allow audit firms to attain a heightened sense of moral, pragmatic and cognitive legitimacy?

One explanation is that only passive support is required. Respondents reported a general sense of confidence in the South African Audit Profession, views corroborated by the fact that the country has been ranked first globally for the quality of its accounting and auditing practices (IRBA, 2010b; IRBA, 2012c). As explained by Suchman (1995) and DiMaggio and Powell (1983), if an organisation seeks simply to retain its status as a trusted independence assurance provider, the 'legitimacy hurdles' that need to be overcome are relatively low. A more critical perspective is, however, also possible.

As noted in Section 2.3, the audit profession has frequently been likened with a 'black box', into which regulators seldom wish to peer, questioning developments purporting to improve audit practice or its perceived legitimacy (Power, 1994; Sikka et al, 1998). At the same time, the relevance of political self-interest (Unerman and O'Dwyer, 2004; Humphrey, 2008), as well as the possibility of arms-length regulation being too 'enclosing' to yield material benefits (McMillan, 2004) should not be overlooked. It may also be the case that the exogenous control

---

<sup>91</sup> The IRBA simply discloses the number of RI's, categorised very broadly according to their nature (IRBA, 2012b). Access to specific information is restricted.

over the audit profession amounts to what Suchman (1995), Ashforth and Gibbs (1990) and Meyer and Rowan (1977) describe as a ceremonial legitimisation tactic. The legitimisation potential of new laws and regulations may be rooted in simple *perceptions* of producing value for constituencies or by *superficially* drawing parallels between aspects of auditing and the ideals of pragmatic, moral and cognitive legitimacy.

---

### 6.2.1: LEGITIMACY AS A BY-PRODUCT OF THE REPORTABLE IRREGULARITY PROVISIONS

---

As discussed in Section 6.1.2, the institutionalisation of an external regulatory paradigm overseas (Malsch and Gendron, 2011), coupled with the need to reassure stakeholders of the continued credibility of local corporate governance systems (Nel, 2001; Manuel, 2002; Konar et al, 2003) has led to a number of regulatory reforms including the entrenchment of the auditor's whistle-blowing duties. This not only reaffirms the relevance of isomorphic forces described in Section 2.3 (Suchman, 1995) but also substantiates the views of Power (1994; 2003) and Humphrey (2008; 1990): that a sense of credibility is critical for the audit profession given that its processes and, for the most part, outputs are not directly observed and evaluated. Several respondents, however, questioned if any claims to legitimacy were substantive:

'Government didn't spend a lot of time thinking about the APA. They saw that there were problems in the USA [referring to the collapse of Enron and Arthur Andersen]. They also knew that maintaining South Africa's reputation as a thought leader in accountancy and corporate governance was very important for the economy and their own reputation and position. So they appointed a number of different people to investigate how auditor regulations could be improved. (The Nel Commission was part of that.) In fact, the guy who actually wrote s45 [of the APA] was not a South African. He was also not specifically asked by Government to fix up the old reporting duty [per s20(5) of the PAAA] but he made the recommendation and [the Minister of Finance], eager to show that we were doing something about this international issue of the profession regulating itself, just agreed with it' (U14).

'My sense of it is that the Government loves form and ignores the substance [of its regulatory developments]. They had dozens of meetings to [discuss the APA and RI provisions] that led to absolutely nowhere. I think that Government loves to *be seen* as doing things but doesn't actually start anything' (U4).

'You know how it goes: whoever pays the piper chooses the tune. That was the perception issue that they wanted to address (E4). 'The whole change to the whistle-blowing duty that you [the researcher] refer to was about perceptions of the audit profession not being able to regulate itself' (U11). 'They did not have conclusive evidence that this was the case, but it didn't matter – what was important was perception management. They had to show that, even though we are a young democracy, we were on top of the game and were doing something (or at least seemed to be doing something) about the legitimacy of the audit profession in South Africa' (U14).

Rather than being specifically designed to improve audit quality, enhance corporate transparency, foster a sense of accountability, and add to the legitimacy of the audit profession, the RI provisions are regarded by some respondents as more concerned with managing perceptions (U1) and introducing a 'quick fix' (U14; E1; E5) in reply to a perceived crisis of confidence in the audit profession's self-regulatory franchise:

'The Government wanted to show that it was also bringing in laws backed by steep fines and promoting whistle-blowing, just like the USA was doing with SOX...but they had no idea about what auditing actually is' (U11) and 'no idea about how this legislation would work in the real world' (E14) but '[s45 of the APA] requires Government to do very little; it looks good on paper; and it gives the Government something to show the World Bank when they ask about the controls we have in place over the capital markets' (U14).

'Obviously, however, we should have more than just imagery. Unfortunately [Section 45 of the APA] could be an example of a check the box exercise...of something with form but without substance. To some extent it may be a case of Government not having the resources or the know-how and it is now creating this legislation to make things look good from the outside' (U4).

Per Power (1994, p. 23), corporate failures tend to be followed by additional regulation and codification of the audit profession with an aim to creating the impression that the audit process is 'immunised' from failure, something which 'requires a good deal of cosmetics' (Meyer and Rowan, 1977; Carruthers, 1995; Suchman, 1995). As argued in Section 2.3, audit remains a 'black box' (Power, 1994) which regulators, either due to a lack of expertise or resources (E1; U4), are incapable (or unwilling) to 'unpack' (U4). The result is hastily enacted legislation (U11; U14) which may not lead to material positive changes to audit practice (Chapter 4) but which makes it appear as if additional controls have been put in place to 'beef up' (U14) the audit process and 'make the Government look proactive' (E14). For example, several writers have argued that threats to independence and underlying capitalistic pressures may be eroding the cognitive legitimacy of the audit profession (Section 2.3). In response, governments may rely on external regulation to preserve a measure of credibility (Power, 1994; Unerman and O'Dwyer,

2004; Malsch and Gendron, 2011) but these measures, being largely superficial, may have done little to tackle erosive capitalistic pressures:

'What does the legislation do to deal with the rogue auditor? The legislation doesn't necessarily call that person to become ethical. At the end of the day, all that you've done is make life more difficult for the honest. It's similar to the issue of trying to lower the speed limit in order to reduce carnage on the road. The answer is quite simple: take on the taxi industry<sup>92</sup>. But Government doesn't want to do that because it's politically difficult. Politically, it's inconvenient. So they don't do it' (U4).

'The "correct" answer is that s45 [of the APA] makes auditors more ethical. Practically, however, it does bugger all. Why is it like this? It's far simpler to create a piece of legislation to make it seem like you are doing something than to actively tackle the problem [of a possible decline in auditor independence] – to get your hands dirty, so as to speak. Government still gets the political points but with half the fuss' (U14).

'The conclusion: 'self-regulation is not, in itself, the cause of scandals. It does not explain why people don't do what they ought to....Self-regulation can actually work perfectly well if people are honest. The real issue is integrity of the people involved. We need to tackle the problem with integrity and independence, and greed and the Government's [rules and regulations] just aren't doing that – probably because the politicians don't know how to fix this. So they make things look good on paper' (U5).

For several respondents, the reporting protocols per s45 of the APA – coupled with the associated disciplinary consequences for non-compliance – are merely claims to protecting the public while, in a practical sense, few changes are introduced, leaving notions of legitimacy illusory (Meyer and Rowan, 1977; Carruthers, 1995; Paisey and Paisey, 2012). In line with the arguments of Unerman and O'Dwyer (2004) and Power (1994), one reason for this *modus* is the role of the attest function in ensuring the sound functioning of investment markets, coupled with the self-interest of the regulators and politicians who are dependent on the sound functioning of the capital market system for the support of constituents (Section 2.3):

'Considering the concerns raised over self-regulation after Enron and a number of domestic corporate failures, 'the legislation was motivated by two things. Firstly, they wanted to show the rest of the world that we were also moving towards more external regulation and that we weren't just letting our auditors regulate themselves...Secondly [and more importantly], the legislation is about

---

<sup>92</sup> The respondent is referring to the large number of road accidents usually involving the country's different taxi associations and which, over time, have become synonymous with reckless driving. The respondent explained that, due to the fact that a large number of South Africa's working class depend on the industry for transport to and from work, there is the *perception* that Government deliberately chooses to avoid upsetting the industry with additional laws and regulations aimed at improving transport standards for political and/or economic reasons.

marketing. By creating this reporting function, we can demonstrate this great thing that we make the auditors do. That it's all really bullshit is not the issue. What's important is making our otherwise inefficient Government look like it's getting up off its arse when the you-know-what looks like it's starting to hit the fan' (U10).

'Basically, they [regulators] are making us jump through 101 hoops. They want to make it seem like they are in control by making us comply with these reporting duties...Whenever there is a failure, somebody needs to be blamed and first one that they chose to blame was the auditing profession. The Government was desperate to make it seem like they weren't falling asleep behind the wheel, especially since they have [only been in power since 1994]...So you end up with a person like Trevor Manuel<sup>93</sup>, getting involved. He's got no clue. He has no background in accounting and auditing. He actually used to be a quantity surveyor...but he gets involved and we end up with RI's' (E5).

What these comments highlight is a paradox. On the one hand, Guenin-Paracini and Gendron (2010) theorise that auditors frequently serve as scapegoats in the aftermath of corporate scandals allowing the credibility of the capital system to be preserved in the process. By introducing reforms to address shortcomings that are perceived as the 'cause' of audit failures, a 'firewall' is created between past actions and experiences and current assessments by key constituents (Suchman, 1995). Arms-length regulation becomes an important means of reassuring stakeholders that governments are dealing with the underlying problem, taking proactive steps to address the fault and reduce the likelihood of its re-occurrence, securing continued support in the process (Unerman and O'Dwyer, 2004; Malsch and Gendron, 2011; Tremblay and Gendron, 2011; Humphrey, 2012). In the meantime, the audit system remains a complex one, its processes and outputs frequently incapable of direct observation and objective assessment (Chapter 2). Consequently, regulation aimed at 'correcting' perceived weakness in the audit system tend to be 'poorly thought out' (U8), 'superficial' (U10), 'window-dressing' (E5) and more about perception management on the part of regulators than an example of *bona fide* change to audit practice in the name of improved audit quality (E5; U1):

'Government just wanted to make it seem like it was doing something....that it had power over the profession'<sup>94</sup>...[and, therefore] I don't think that [s45 of the APA] truly legitimises audit to the users of the audit reports.... I think it ends up just being a reporting requirement and anything extra is smoke and mirrors' (E5).

---

<sup>93</sup> Trevor Manuel was the South African Minister of Finance at the time when the Draft Accountancy Profession Bill (2001) was tabled. The Bill gave rise to the APA and, with that, the replacement of MI's with RI's (Section 2.1).

<sup>94</sup> The possibility of the RI provisions being a source of disciplinary power is discussed in more detail in Chapter 7.

'In a way, Government suffers from a type of Third-World inferiority complex' (E5). 'So it wants to come across as being proactive. That's very much part of the South African regulatory culture...But it's ultimately a big a perception game. What happens to those reports? Who follows up on them? Do any improvements actually transpire?' (U2).

Adding to the interviewees' argument that legitimacy gains associated with the RI provisions are superficial is the possibility of the external regulation being akin to a set of rigidly defined rules and tantamount to an 'enclosing control' over the profession (Section 7.2). For several respondents, a legalistic culture results. 'Professional conduct' is reduced to adherence to the parameters of an act rather than truly about societal interests (see also Roberts, 1991; Roberts, 2001; McMillan, 2004; Vakkur et al, 2010). Any perceived legitimacy inherent in 'professional conduct' is then not substantive. Instead, resulting legitimacy is simply a by-product of mandatory conformance (E17) in direct contrast to seeking to control the profession by 'expounding its ideals' and fostering 'prudential professional judgment' (McMillan, 2004, p. 946). For example:

'The [whistle-blowing duty] may be a senseless thing. There is a very real risk that all that happens is just mindless compliance with the rules. All that may happen is that [auditors] finds an RI and report it, not because they feel morally obligated or believe that they will add value for shareholders, but because the [APA] told them to. What would happen if the same act told them to jump off a bridge? The sad thing is that some of them probably would' (E5).

'So the real problem is that people do not question what they are doing. They just come and do it. There is no thought process.....We now have an overregulated situation where everyone is focused on doing something because that's the way it is – and once you do that, you can never [add value] because all you are trying to do is tick the boxes' (U5).

'Compliance' may not, therefore, be indicative *only* of a conformance strategy aimed at genuinely securing added legitimacy as was argued in Section 6.1. Value derived from reporting - or parallels with moral or other societal duties - are a by-product of a legalistic culture concerned only with the letter of the law. In other words, there is a risk that superficiality (U12) may taint claims to moral and pragmatic legitimacy. The findings from Chapter 4 may lend weight to this argument. For example, on the matter of engagement performance:

'We have the **standard** agenda for our [planning meetings]. **It's the same** – you tell the team what an RI is and what to do if you find it' (E2, *emphasis added*).



‘...and there are **the standard** [requirements] on the audit file where you have to consider if you have discussed the legislation with the team and have documented your rationale for reporting or not reporting something (if necessary). And after that, **you sign it off and it’s done**’ (E7, *emphasis added*).

‘Standardisation’ and clearly defined protocols may be a means of improving performance judgement (Ashton, 1992) in the context of managing audit risk resulting from heuristics and reliance on conceptual auditing standards (Owhoso and Weickgenannt, 2009; Hardies et al, 2011). ‘Mechanisation’ of the reporting duties enshrined in the RI provisions may, however, point to a possible migration from applying professional judgement in favour of simple consideration of how to apply the law. Rather than adding value for stakeholders, including an improvement to the whistle-blowing machinery, ‘detailed implementation to the letter of the law [becomes]....the sole skill’ at work (McMillan, 2004, p. 946) making it difficult for several users and experts to accept the RI provisions as a *real* source of pragmatic and moral legitimacy for the audit profession.

These views should not be construed as implying that s45 of the APA has *no* bearing on the legitimacy of the audit profession. Chapter 4 and Chapter 5 highlighted instances when respondents felt that the RI provisions played a relevant role in positively impacting audit practice. As discussed in Section 6.1, some respondents also conveyed a belief that reporting transgressions allowed auditors to meet the expectations of different stakeholders and align the profession with societal ideals in favour of whistle-blowing. It cannot, however, be said that this is exclusively the case. At least some element of legitimacy appears to be a by-product of a legalistic mindset and the result of powerful symbolic displays and institutional processes (as alluded to by Meyer and Rowan, 1977; Suchman, 1995; Unerman and O'Dwyer, 2004).

---

### 6.2.2: SYMBOLIC DISPLAYS TO GAIN LEGITIMACY?

---

Although a paradigm shift in audit practice has not resulted from the RI provisions (Chapter 4; Chapter 5), the relevance of the whistle-blowing duty may rest not in ‘detailed matters of practice’ but ‘in the potential power of the image it created’ (Humphrey et al, 1993b, p. 43). While Section 6.1 argued that the reporting duty could be seen as a genuine source of auditor legitimacy, an alternate interpretation is that legitimacy is a product of clever symbolism.

‘Outputs, procedures and structures...can all signal that the organisation [is legitimate]...even if these supposed indicators amount to little more than face work’ (Suchman, 1995, p. 588).

In this context, despite the RI provisions not leading to a radical change in audit practice; resolving the expectation gap; or even culminating in *confirmed* quality and reporting gains (Chapter 4), for several respondents, all that was relevant was simply that a formal reporting duty, existed<sup>95</sup>. This is not a repetition of Section 6.1: that formal reporting standards reinforce a sense of pragmatic and moral legitimacy. On the contrary, what this almost ‘blind trust’ (E14), highlights is how simply the *potential* for whistle-blowing becomes an important source of *assumed* moral and pragmatic legitimacy. In other words, conceptions of legitimacy are interconnected with the use of clever symbolic gestures that may even negate the need for tangible and substantive reform (Meyer and Rowan, 1977; Suchman, 1995; Unerman and O'Dwyer, 2004). As part of this process, efficiency is no longer paramount. Paradoxically, it may actually ‘undermine...ceremonial conformity’ (Meyer and Rowan, 1977, p. 341) as formal structures that ‘celebrate myth’ are often different from those required for efficiency (Meyer and Rowan, 1977; Humphrey and Moizer, 1990; Humphrey et al, 1992; Power, 2003).

Meyer and Rowan (1977) provide a bus company, expected to service a particular route even if it has no passengers, as an example. By analogy, a reporting institution under the APA that requires the IRBA to be informed of irregularities, even if they are not highly consequential (Wielligh, 2006), may be another. Several respondents noted that one explanation for otherwise immaterial irregularities being reported could be sanctions for non-compliance (Chapter 7) causing auditors to be conservative when deciding whether or not to report an irregularity. Similarly, the APA uses terms - such as ‘material’ and ‘fiduciary duty’ – that need to be interpreted by auditors and applied to each context. Respondents noted that this could lead to a degree of uncertainty as to whether or not an ‘RI’ had indeed resulted and ought to be reported. In the context of a professional and statutory duty, auditors may again choose to inform the IRBA, rather than refrain from reporting. As a result, the reporting of immaterial issues to the

---

<sup>95</sup> This cannot be attributed solely to the classic expectation gap synonymous with misinformed stakeholders (Humphrey et al, 1992; Porter, 1993; Dennis, 2010). Users have several years’ experience dealing with auditors and operate exclusively in a financial or regulatory role (Section 3.3). Experts are also senior members of established South African audit firms, well versed in the requirements of ISA and auditor regulation.

Furthermore, the findings to this point have not given any indication that respondents have been unwilling to discuss the case for s45 of the APA openly with the researcher, frequently providing detailed, emotive and, in some cases, possibly controversial accounts.

regulator could be attributed simply as an unintended consequence of the wording and operation of the RI provisions (SAICA, 2001 cited in Nel, 2001; Wielligh, 2006). Alternately, a broad reporting duty could serve as a type of check and balance that could reinforce the perceived value of the RI provisions as touched on in Section 4.3:

'Why not just rely on professional judgement to decide when to report? Maybe because that is too vague...As soon as you start to interpret stuff in a more relaxed way, that is when ambiguity sets in and you start to get competitiveness...Suddenly an audit firm may start to get a reputation for being more relaxed about RI's and use this to attract clients and that would just defeat the whole point of the legislation' (E6).

It is, however, possible that an increase in reporting is an important, and ironically subtle, means of legitimising audit. The RI provisions – which, purportedly, took cognisance of the fact that the preceding reporting duty was characterised by a lack of disclosures (Section 2.1) – have led to an increase in the number of reports issued to the IRBA. The assumption, especially from the perspective of non-expert users, is that because the physical number of reports issued to the regulator has increased under s45 of the APA – as compared to s20(5) of the PAAA – the reporting duty makes a material impact on the governance landscape (U1; E5; E14)<sup>96</sup>. 'That [very few people] ever see the detailed statistics on the RI's kept by the IRBA does not seem to have crossed most people's minds' (U14). Consistent with the work of Meyer and Rowan (1977), ceremonial processes come to be divorced from underlying technical activities in the quest for legitimacy (Section 7.2):

'It's all smoke and mirrors. The whole point is to increase the number of reports because they [regulators] want to make it seem as if they are doing something. They can turn around and tell everyone: "look, the number of cases of whistle-blowing has increased" and because people assume that whistle-blowing is good [Section 6.1], they automatically assume that the APA is working and so that legitimises audit' (E5).

'It really does not matter what is reported. When the APA was being discussed there was a lot of criticism that trivial things would be sent up to the regulator<sup>97</sup>. But it never mattered. What was

---

<sup>96</sup> The IRBA (2012b) confirmed that approximately 3000 RI's have been reported, representing a significant increase above the number of irregularities reported under the PAAA.

<sup>97</sup> Several respondents raised the issue of trivial matters being reported to the IRBA (Wielligh, 2006). For some, this is an unintended consequence of the legislation or the result of wanting to avoid otherwise relevant issues not being reported due to misapplication of professional judgment, as touched on in Section 6.1 and Section 4.3. That such a consequence may be reminiscent of entrenching a sense of surveillance or an act of 'dressage' aimed at addressing the subjectivity inherent in audit-decision making is discussed in more detail in Chapter 7.

important was not adding real value, it was about impression – making it seem like we had done something and the broader reporting duty [Section 2.1] and the increase in reports was the “proof” (E14).

What is, therefore, important for stakeholders is simply the appearance of a rational and effective formal reporting protocol included in South African legislation. The technicalities concerning the practical implementation of the whistle-blowing duty are largely overlooked. Consequently, it does not matter that the benefits associated with the RI provisions cannot be quantified (U2; E5); that IRBA may not be able to deal with every report (E5; U10); or that some auditors may, despite the threat of sanctions<sup>98</sup>, disregard their reporting duty (E9; U5). Legitimacy is a product ‘of maintaining the appearance that the [whistle-blowing] myth works’ (Meyer and Rowan, 1977, p. 356) something also highlighted by the ‘broad catch all’ (U2; U10) designed to encourage reporting and improve transparency (Section 2.1):

‘It does not really matter that the finer details of the APA have not been worked out. For example, there is uncertainty about what some of the terms [in the APA] actually mean. I’m thinking about terms like “management board” and “breach of fiduciary duty”. We don’t have a clearly defined meaning for these terms and we don’t apply them consistently as a result. Now I know that the IRBA has been talking about bringing out some extra guidance. We already have a 100 page manual but all it basically says that “it’s all very legal and complicated and for a Court or a group of lawyers to decide what the RI’s actually mean”. In any event, who knows when this new guidance is going to come out? They have been talking about the problems with the meaning of the legislation since they were writing the thing. I think that the biggest issue was not the nitty gritty details – for them [the regulators] it was about getting the RI’s up and running in response to audit failures at home and overseas’ (E14).

Paraphrasing Expert 14, what is relevant is not the technical efficiency of the RI provisions, but simply the ability to assume rationally that the RI provisions are effective (E5; E1; U1; U2). Ambiguity in the APA and IRBA’s guide may simply be an unforeseen consequence of the operationalisation of the reporting duty (U7; E1). The disconnect between the absence of a robust conceptual approach for dealing with RI’s and elements of pragmatic and moral legitimacy, however, reaffirm the theorisations of Meyer and Rowan (1977). The RI provisions are tantamount to an institutionalised reporting mechanism which must be adopted ‘ceremonially’ to cultivate a sense of legitimacy (Hopwood, 1990). Any uncertainty in the application of the RI provisions, thus, plays an important part in ensuring continued confidence

---

<sup>98</sup> This is discussed in more detail in Section 7.3.

in the whistle-blowing process (see also Meyer and Rowan, 1977; Fogarty et al, 1991; Suchman, 1995). Any technical inconsistencies or ambiguities must, thus, be decoupled from the image of the s45 of the APA as conceived by the State and its regulators to improve the audit reporting process and its perceived public standing. The result is that while audit practice may not have changed (Section 4.1; Section 4.2) and that any gains in terms of the quality of audit reporting are not guaranteed (Section 4.3), comments such as the following were common:

'Yes, it's true – [we] don't ask the IRBA for detailed statistics on the RI's or about the value that has been added specifically [by the RI provisions]. I don't think that anybody has ever asked the IRBA for a list of people or companies that have been reported.....**But I think that the legislation is a good thing**' (U7). 'It **definitely** adds something' (U3) (emphasis added).

'When I say that people are complying with the legislation, it's **certainly a "gut feel"**...but the auditor is reporting something **and I think** it's being done properly (U7) (emphasis added).

'Look, we have no real way of knowing if auditors are doing what they are supposed to.....**but I would not delete s45[of the APA]. It's a good piece of legislation** that says "look, if you find something...you need to report"' (E9) (emphasis added).

Prima facie, the RI provisions are regarded as a reporting mechanism that meets the information needs of stakeholders; addresses calls for more active reporting by auditors; and purportedly serves the public interest. What the above comments highlight is that RI provisions also have an important marketing role to play (see also Hopwood, 1990; Humphrey and Moizer, 1990). By creating a reporting duty which appears broad and grounded in the desire to bring, *inter alia*, 'material breaches of fiduciary duty' to the attention of independent regulators, the whistle-blowing duty appears rationally effective. As argued by Khalifa et al (2007) and Humphrey and Moizer (1990), the RI provisions cultivate a reporting discourse which Section 4.3 and Section 6.1 argue appeals to the desire to improve audit reporting quality and serve the public interest. The whistle-blowing duty becomes a powerful symbolic display of how external regulation is adding to the audit process, legitimising it in the eyes of constituents. There is, however, a clear tension. We have legislation that is difficult to apply in a practical sense and an apparent absence of conclusive evidence that s45 of the APA has materially altered audit. Juxtaposed with this is the general assumption that the RI provisions are an important component of the rituals of the attest function, especially from the perspective of non-expert users who are unable to observe directly the audit process and handling of RI's (E1; U9).

This tension is, however, largely overlooked. (see also Fogarty et al, 1991; Power, 1994). Instead, an assumed confidence sets in. This is a product of the existing legitimacy reserves of the audit profession, implying that the RI provisions and cumulative standing of the audit profession, become mutually reinforcing, each bolstering the other and strengthening the profession's claims to legitimacy (Sikka and Willmott, 1995; Power, 2003). Simultaneously, a sense of good faith is rooted in the ambiguity of the RI provisions and, paradoxically, in the fact that there is a clear lack of visible, measurable output that would allow any inconsistencies between the technicalities of the APA to be in contrast with perceptions of constituents (see Meyer and Rowan, 1977; Fogarty et al, 1991; Suchman, 1995). The result is the 'absorption of uncertainty' and a 'contribution to a general aura of confidence' (Meyer and Rowan, 1977, p. 358) in the reporting mechanisms and, by inference, the audit process.

Formalisation of the reporting may be integral to this. Formal structures and processes provide a rational explanation for how and to what end activities are carried out and interconnected (Meyer and Rowan, 1977; Molm, 1986; Power, 1992). Through the lens of legitimacy theory they become 'manifestations of powerful institutional rules which function as highly rationalised myths that are binding on particular organisations' (Meyer and Rowan, 1977, p. 343). In this light, several users felt that the fact that the reporting duty is a statutory one backed by step-by-step processes is *itself* a source of legitimacy. Explaining why, for example, in the absence of irrefutable published evidence that the RI provisions were making a positive contribution to society, the provisions were still perceived as value-adding, respondents felt that:

'People are reassured by the reporting duty 'partially **because formal protocols exist**. There is a clearly defined mechanism for reporting that is backed by legislation' (U2, emphasis added).

'And the fact that [auditors] are required to prepare **a formal letter** to the IRBA which triggers a formal process of informing regulatory authorities **shows** that [s45 of the APA] **means something**' (E16, emphasis added).

The requirement to report formally 'demonstrates conviction and seriousness' (E7) and **definitely** 'leads to more emphasis [on the reporting duty] from the IRBA (E1, emphasis added).

The reporting duty is interpreted by users as a source of consequential legitimacy. It is consistent with moral convictions about whistle-blowing and the ideological role of auditors in identifying and reporting irregularities (Humphrey and Moizer, 1990; Sikka and Willmott, 1995; Power, 2003). Respondents went on to explain that creating a homogenous response for

dealing with irregularities reiterates a sense of legitimacy resulting from statutory reporting protocols (see, for example, Humphrey and Moizer, 1990; Power, 1992; Power, 2003). Experts, for example, often relied on the need for consistent reporting as a means of justifying whistle-blowing to clients (Chapter 4; Chapter 5). Simultaneously, users attributed the assumed consistent reporting standards as one reason for valuing the RI provisions, a move largely in line with the prior work on whistle-blowing (consider Read and Rama, 2003; Nam and Lemak, 2007; Hwang et al, 2008; Seifert et al, 2010). Reinforcing these views are the procedural requirements of s45 of the APA (PwC, 2006); a formal guide to interpret the legislation and how and when to report (IRBA, 2006); the development of official templates for reporting (Appendix A6-A8); and the creation of an independent, professional complaint recipient (Nel, 2001; Konar et al, 2003). Each becomes part of the 'ceremony' of reporting. Legitimacy is derived from this 'ceremony' and the preconceived belief in the apparently rational, legal, and formal reporting process.

For these reasons, when explaining *why* the act of whistle-blowing by external auditors was perceived as socially desirable and in the public interest (Section 6.1), respondents seldom cited specific detailed examples of the RI provisions in action. Instead, 'technical procedures...become taken for granted means to accomplish organisational ends' (Meyer and Rowan, 1977, p. 344), especially in the context of external audit given the opacity of underlying processes (Power, 1991; Power, 1994). If one then considers the general market participant, not fully cognisant of the audit's role and functions, legitimacy is easily achieved without the need to engage in costly - and potentially difficult - exercise to reform audit fundamentally (Zeff, 2003a; Zeff, 2003b; Wyatt, 2004; Pesqueux, 2005). It is possible to espouse socially desirable practices, in this case whistle-blowing (Section 6.1; Section 2.1), by appealing to readily accepted 'truths' or 'beliefs' while technical difficulties, such as threats to independence or impracticalities encountered when policing s45 of the APA (Section 7.2), are marginalised:

'The public would not know about [s45 of the APA] and so they cannot have perceptions about it. They cannot internalise any direct benefits and since nothing has changed on the ground there may be nothing to internalise anyway. So why then do we have this regulatory requirement? For the same reason that you regulate doctors and nurses and lawyers: it reassures the public to know that there is some [formal regulatory requirement] even though the public has no idea of the nitty-gritty details. They just know that because these people are all important parts of society (doctors, nurses and auditors) they must be regulated' (U1).

'On the one hand, you make a show of reporting wrong-doing; of blowing the whistle on improper conduct that plays to the belief of what the auditor ought to be doing in terms of this picture in our heads of the "watchdog". At the end of the day, there is a general assumption of whistle-blowing being an invaluable part of corporate governance and what the auditor is doing ties in nicely with that. What s45 of the APA does is basically "marry" auditing and whistle-blowing by solving the problem of not being able to tell someone because of a duty of confidentiality. In the meantime, there could be a profit motive that makes some auditors cut corners. There could be a need to keep the client happy that means that some important things don't get reported and that is how business is then done on the ground. The man on the street has no idea about this and just assumes that there are all of these new regulations and all this extra reporting, so everything must be all right' (U14).

Adding to this assumed confidence is the institutionalisation of external regulation going-hand-in hand with its proliferation in international jurisdictions (Malsch and Gendron, 2011; Tremblay and Gendron, 2011). The growing legitimacy of arms-length regulation as a means of restoring confidence in the audit profession means that enacting s45 of the APA can add to the credibility of the audit process, even if the reporting duty leads to few significant changes. The effectiveness of new laws and regulations may be effectively side-lined by simply mirroring apparently successful regulatory bodies abroad. In other words, the processes of mimetic isomorphism discussed in Section 6.1.3, may allow politicians simply to create the perception of active change that reassures constituents of the sound functioning of corporate governance systems (E5; U5). In other words, it does not matter that s45 of the APA does not produce radical changes 'on the ground' (U1) or that external regulation, in general, may not be effective in improving audit quality (see Bronson et al, 2011). The reporting duty is afforded legitimacy simply by inference or assumption:

'S45 of the APA is a bona fide effort at regulating the profession. It is backed by legal process and mirrors changes abroad' (U6).

'One of the major sources of legitimacy is about the perception of "keeping up with Joneses" (U5). 'After all, if the USA has SOX – and it creates a duty to report on certain control problems – well, then our RI's must also be a good idea. That is the attitude that some people have' (U14).

'We place a lot of hope in a small piece of legislation (and in legislation in general) to fix our problems and that's often just because other people are doing something similar' (U2).

'The reality, however, is that it's much easier for Government to introduce an Act than it is to tackle the issue head on. They can turn around and say: "We have legislated against this and that and we



have given the auditor these extra duties". All of this makes it look like they are doing a great job and creates the impression, and I think it's a false impression, that they have added something significant to the governance landscape' (U8).

That the s45 of the APA was part of an impression management exercise is supported by South Africa's most recent regulatory developments. The Companies Act (2008) (effective from 1 May 2011), potentially expands the reporting duty embodied by s45 of the APA by creating a largely equivalent duty for independent review engagements (Regulation 29, Companies Regulations, 2011). Initially, this seems consistent with the argument presented in Section 6.1. Per several experts, having recognised the value for constituents and moral capital inherent in the whistle-blowing duty under the APA, the scope of this reporting duty ought to be expanded. Experts, however, pointed out a key contradiction. As opposed to its predecessor, the Companies Act (2008) effectively allows the vast majority of registered companies, to be neither audited nor reviewed. In such instances s45 of the APA and Regulation 29 would be rendered inoperative. According to respondents, the majority of reportable irregularities pertain to unlisted entities which, under current regulations, would now be exempt from independent assurance requirements (Maroun and Wainer, 2013)<sup>99</sup>. This is in direct contrast with the view of s45 of the APA being a source of pragmatic legitimacy. Private companies, unlike their listed counterparts, are under no obligation to disclose information, including issuing financial statements, to the general public (U10; E1). One of the primary means by which irregularities would thus be brought into the open would be via the RI mechanism now rendered inoperative (Maroun and Wainer, 2013; E1; U10).

Respondents were split on their interpretation of this. Some suggested that, despite changes to the Company Law, independent reviews would still fall within the scope of either the RI provisions or the equivalent Regulation 29. That some companies would be neither audited nor reviewed was seen as allowing audit – and the IRBA – to focus its attention on more material organisations where the public interest would be better served. Others offered the tension between the APA and Companies Act an example of an 'unintended consequence' (U9; U1) of regulatory developments. This has the potential to detract from the utility of legislation in the eyes of constituents, thereby eroding pragmatic legitimacy (E1; U10). A more critical interpretation is that if s45 of the APA had been *bona fide* enacted with an aim to adding value for stakeholders and aligning the audit profession with societal expectations and moral ideals

---

<sup>99</sup> Bear in mind that unlisted entities are not subject to the same extent of scrutiny by capital providers and regulators, most notably the JSE (U6; U9).

inherent in whistle-blowing in general, it is unlikely that the legislature would overlook a tension between the s45 of the APA and the Companies Act (2008) (E1; E2; U9; U8). It may be possible that the decision to exclude the majority of companies from the requirement to be subject to either an independent audit or independent review is an indicator that policy-makers never intended the RI provisions to be anything more than a superficial means of reassuring the local public and international investors that South Africa was not relying exclusively on a self-regulatory framework for the audit profession.

### 6.3: SUMMARY

---

Chapter 4 and Chapter 5 explored whether or not the RI provisions are an example of external regulation designed to address agency risk by improving audit quality. Some evidence was found in support of this claim. The reporting duty did have relevance for perceptions of auditor independence and the quality of information being reported. It did not, however, have a material impact on the 'nuts and bolts of audit'. In addition, that it offered material benefits in terms of enhanced auditor independence was not universally accepted. Despite this, respondents largely supported the whistle-blowing duty and almost unanimously agreed that the RI provisions should not be dispensed with. A reason for this is that the reporting requirement is a source of legitimacy.

The obligation to blow the whistle on transgressions can yield benefits for different stakeholders, implying a source of pragmatic legitimacy. Contemporaneously, several respondents cited the act of reporting irregularities as socially desirable, improving the quality of the audit report; enhancing corporate transparency; and ultimately being an act in the public interest resulting in claims to pragmatic and moral legitimacy<sup>100</sup>. With the prior literature and financial press pointing to the growing acceptance of whistle-blowing as part of the corporate governance landscape, a sense of cognitive legitimacy may also result. This is reinforced by a growing move in favour of arms-length regulation of the audit profession after it has been beset by numerous challenges to its credibility. By entrenching a duty to bring certain transgressions to the attention of an

---

<sup>100</sup> Although the research does not focus on the distinction between large and small audit firms (Section 1.4.2), it is interesting to note that no evidence was found to suggest that notions of legitimacy arising from the RI provisions was impacted by the size of audit practices.

independent regulator, the RI provisions may serve as an example of mimetic isomorphism at work as South African regulators seek to demonstrate the soundness of local capital market systems, including the audit process.

Not all respondents, however, shared these views. Some argued that the RI provisions simply encourage an attitude of compliance. In a legalistic setting, any resulting perception of pragmatic or moral legitimacy is simply a by-product of 'following the rules' (E5) and 'ticking the boxes' (E8), a concern raised by both users and experts<sup>101</sup>. From a slightly different perspective, s45 of the APA may be an example of 'carefully chosen displays of symbolism [that] may circumvent the need for substantive change entirely' (Suchman, 1995, p.: 598). Implementing formal reporting protocols; backing these with legal requirements; and relying on an independent regulator to coordinate the reporting process are used to rationalise the reporting duty. Legitimacy results, not from substantial value for exchange participants or alignment with societal ideals, but rather from the belief in the act of reporting itself. Consequently, most important is the mere existence of the reporting duty which mirrors the institutionalisation of regulation in other jurisdictions. Processes of decoupling and 'logic of confidence' are at work allowing concerns about the practical implementation of the RI provisions and their efficiency to be separated from the image of active whistle-blowing leading to material corporate governance improvements.

Claims to legitimacy – whether substantive or symbolic – may not, however, be the only processes at work. Several respondents alluded to the possible presence of disciplinary power. Fines and imprisonment, for example, become 'punishments' for non-conformance; the procedural nature of the APA may be regarded as 'enclosing' in nature; and there may be a sense of rendering both the auditor and the audited 'visible' by virtue of the operation of a piece of legislation that effectively mandates whistle-blowing. Similar to the change impetus of industrialisation that Foucault (1977) identifies as underlying the move towards forms of disciplinary power, the need for a perceived sense of 'visibility' or 'control' over the audit profession after it is beset by a crisis of trust gives rise to Panoptic-like attributes of recently enacted external regulation. In other words, one reason for demands for arms-length regulation to supplant the self-regulatory framework for the audit profession may be attributed to notions of disciplinary power. Motifs of surveillance, examination and normalising sanction may be at work in external regulatory developments reassuring users of audit reports that practical and socially

---

<sup>101</sup> Both experts and users shared critical views on the RI provisions. Per Section 1.4.2, however, that respondents are subject experts means that we cannot exclude the possibility of an expectation gap between auditors and users in general (Section 8.3).

desirable change at both the audit client and audit firm is taking place. In this context, Chapter 7 explores whether or not aspects of the RI provisions may be reminiscent of Foucauldian power and control. The Chapter also considers how motifs of disciplinary power may be closely related to notions of legitimacy, whether *bona fide*, or part of the institutional processes of decoupling.

## 7: SECTION 45 OF THE APA: NOTIONS OF DISCIPLINARY POWER

---

This chapter adds to the debate on the role of the RI provisions in South Africa by examining the operation of elements of Foucauldian power and control in the whistle-blowing duty. As explained in Section 2.4, the move from self- to arms-length regulation of auditing signals a slide along a social continuum from trust vested in financial reporting and auditing to one where, increasingly, stakeholders come to distrust these processes (Power, 1994; Pentland, 2000). In examining the role of s45 of the APA in connection with audit quality (Chapter 4; Chapter 5) or as a means of legitimising the audit profession (Chapter 6), what has not, however, been fully dealt with are the characteristics of external regulation that allow it to win the confidence of stakeholders in the aftermath of corporate debacles and to gain institutional status (Malsch and Gendron, 2011). To this end, this chapter concentrates on how, in addition to making tangible changes to audit practice (Chapter 4; Chapter 5), integral to RI provisions' ability to serve as an alternate source of legitimacy for the profession (Chapter 6) are elements of enclosure, power, control and sanction that reassure users of audit reports that regulators are responding to the most recent crisis of confidence (Unerman and O'Dwyer, 2004; Black, 2008; Malsch and Gendron, 2011). Accordingly, the final research question asks:

***C: Is s45 of the APA an example of surveillance machinery and a manifestation of disciplinary power?***

Section 7.1 commences by exploring interviewees' perceptions, pointing to parallels between the RI provisions and: principles of enclosure and the efficient body, disciplinary power and a sense of surveillance. This is followed by Section 7.2 which builds on Section 7.1 and Section 6.1 by drawing links between conceptions of disciplinary power inherent in the reporting duty and notions of legitimacy. Section 7.3 provides a critical perspective, examining limitations of a

panoptic metaphor for exploring the role of the RI provisions and drawing connections between notions of Foucauldian power and control and symbolic displays of legitimacy per Section 6.2. Section 7.4 summarises.

---

## 7.1: DISCIPLINE AND PUNISH: A CASE FOR THE RI PROVISIONS?

---

---

### 7.1.1: ON PRINCIPLES OF ENCLOSURE AND THE EFFICIENT BODY

---

Interviewees pointed out that the RI provisions, reinforced by the IRBA's guide on reportable irregularities, have, to some extent, changed what it means to be an auditor (Section 6.1). In terms of ISA (IAASB, 2009x; IAASB, 2009e) and codes of professional conduct (IFAC, 2006; IRBA, 2011; SAICA, 2012), confidentiality of client information is of paramount importance. The RI provisions provide an exception to the principle of confidentiality whereby the auditor is obliged to disclose client information under certain circumstances to the IRBA without being compelled by a court of law to do so (see also IRBA, 2006; IAASB, 2009h). Experts explain how the RI provisions augment the professional duty of the auditor to express an opinion on a client's financial statements (IAASB, 2009c; IAASB, 2009s) by effectively establishing a whistle-blowing duty (Section 2.1; Section 2.3; Section 6.1), widening the reporting obligations of the auditor (Section 4.3) and altering the relationship between auditors and users of audit reports in the process:

'One [would] not normally see [various irregularities] coming through in the emphasis of matters paragraphs <sup>102</sup>[of the audit report]. Normally, the emphasis of matter is only about a going concern [problem]...so in many respects the quality of the audit report that is issued, including in the absence of legislation, is inadequate....What s45 of the APA does is expand on what is required from the auditor... The auditor is meant to be a watchdog and that is the message that comes from this piece of legislation' (U3).

Audit is not solely about reporting on compliance of financial statements with IFRS. It incorporates a more active form of monitoring and surveillance which stresses that companies

---

<sup>102</sup> An emphasis of matter paragraph is included in an audit report to draw a user's attention to certain facts or circumstances without modifying the audit opinion (IAASB, 2009t).

'are expected to be good corporate citizens and that there is somebody standing behind them and watching' (U10). While stressing that the reporting duty has not changed the fundamentals of audit practices and detracted from the professional duty to express an opinion on the financial statements (Chapter 4), several experts confirmed that there was a recognised need to provide more than just a standard audit report when certain transgressions came to their attention.

'I don't think that the legislation has anything to do with the [technicalities] of audit but I do think that it, in general, gives informed users some comfort over management integrity...It has become an addendum, in a way, to the audit report. It plays a complementary role providing information over and above the audit opinion' (E8).

'So, from that perspective, it makes us realise that – in certain cases – we have a duty to do more than just issue a generic audit report' (E4).

'[and], as a result, I think that [s45 of the APA] certainly [does] have an impact [on what it means to be an auditor]. It emphasis the role of the auditor- it has placed the onus on the partner to make sure that he is aware [of his public duties]' (E1).

Coupled with an added duty altering the role of the auditor from one who reports on the financial statements to possibly an agent of the public interest acting as a 'watchdog' (Section 6.1), the RI provisions create clear 'enclosures' in turn 'partitioned' by both the legislation, the IRBA's guide (IRBA, 2006) and the hierarchical structures of the audit firms. As explained by several experts, the legislation defines what constitutes a 'reportable irregularity' (s1 of the APA, 2005), coupled with the IRBA's guide (2006) which elaborates on the definition, providing examples of instances where the auditor would be expected to report. In particular, the APA requires any act of fraud, irrespective of its perceived materiality, involving a client's management board, to be reported to the IRBA (PwC, 2006; Wielligh, 2006). This was designed specifically to widen the reporting net and prevent the application of professional judgement leading to reduced reporting<sup>103</sup> (Nel, 2001; Wielligh, 2006).

For this reason, the RI provisions were described by several experts as materially contributing to the 'vocabulary' of audit partners when it comes to defining their reporting duties. Similar to the arguments of Khalifa et al (2007) and Boland (1987), the prescriptions of the APA and the IRBA's (2006) guide constitute the acceptable way of describing and thinking about a particular

---

<sup>103</sup> The RI provisions were also construed as 'defining' what constitutes conduct contrary to public interest and worthy of whistle-blowing. Miceli and Near (1984), Hwang et al (2008), and Nam and Lemak (2007) are examples of the prior literature pointing to a multitude of factors that influence the decision to blow the whistle. In the RI provisions many respondents find an attempt to clarify an otherwise subjective decision-making process.

part of audit practice, effectively 'objectifying' the reporting duty. In the words of Miller and O'Leary (1987, p. 239), the reporting duty may, thus, be an integral part of the 'range of calculative programmes and techniques which come to regulate the lives of individuals'. Although this duty does not totally describe the auditor's function (IRBA, 2006), it certainly contributes to the 'discourse' on the role and to the purpose of audit and the way in which auditors think about their duties (E3; E10; U10).

The regulation also concentrates on the physical act of reporting itself, as an example of the 'roles' or 'tasks' at the centre of panoptic control. Firstly, the RI provisions, read with s1 and s44 of the APA, define the individual responsible for the act of reporting to the IRBA, namely the individual registered auditor responsible for the engagement. This is most likely the engagement partner (IRBA, 2006). While experts pointed out that it is usually an audit team member who will first detect an RI, each of the participating audit firms had established policies explaining the responsibility of the junior auditor and the audit partner, thereby ensuring that roles are clear and partitioned:

'When it comes to reporting, there is a very clear hierarchy. The clerks know that if they suspect that there may be an RI, they need to discuss this with the audit manager as the starting point. From there, the engagement partner will have to be involved. He **absolutely** will have to comply with firm policy on how to deal with the RI and that will involve having to discuss the whole case with the [senior partners responsible for risk-management at the audit firm level]' (E10).

'If you find an RI, it really affects the documentation. When you pick up something at a client - and because your file is also going to be reviewed and exposed to other parties and so forth - it becomes important for you, as the partner, to show that you followed a set of guidelines. And once you are satisfied that you do indeed have an RI, there is very prescriptive, scheduled reporting time-table that you stick to' (E17).

The establishment of specific reporting duties backed by defined roles and notions of accountability effectively compels the individual to behave in a certain, almost rehearsed, fashion reminiscent of the 'temporal elaboration of acts' and 'dressage' which form part of Foucauldian notions of power and control (see Foucault, 1977; Gordon, 1980; Hopper and Macintosh, 1993). In other words, the RI provisions, backed by the IRBA's guide (2006), make it theoretically possible to 'attach to every individual within the [firm] norms and standards of behaviour' (Miller and O'Leary, 1987, p. 242) concerning the reporting duty. The creation of formal structures, contributes to defining the role and purpose of the individual

tantamount to a form of 'bureaucratic coercion' (Fogarty, 1992). Reinforcing this view is the fact that, although junior team members may be involved in the reporting process, this does not detract from the ultimate responsibility of the engagement leader in connection with an RI (E10; E2):

'At the end of the day...the responsibility does not lie with a team member or the manager. It starts with you as the partner because you are the one signing off' (E8).

'The way the system works is that the clerk has to record something on the file. The partner has got to deal with that. Even if it was bullshit...you can't tell them to write it again or write it properly. It's there – it's embedded in the file. And the quality reviewers read that stuff. If you fob something off, you are in big trouble' (E9).

'You will probably document the RI [on] on the audit file yourself. You will review it several times...you make sure it's 100% and you definitely don't delegate this to someone else to do' (E3).

These comments highlight a system of hierarchical accountability established by the operation of the APA, together with the respective audit firm's own policies and procedures for complying with the reporting requirements. Although more junior team members are expected to play their part, it is ultimately the engagement leader who is responsible for how suspected RI's are dealt with. Concurrently, notions of enclosure and partitioning are reinforced by s45(1)(a) of the APA which mandates reporting to IRBA, complemented by s44(1)(4) of the APA which defines the responsibility of the IRBA to inform appropriate regulators, a duty elaborated on by the IRBA's guide (IRBA, 2006; PwC, 2006). The guide provides examples of the types of regulators concerned and certain of the legal processes that would be followed. In this way, there are clearly defined roles or functions which fall to specified individuals. Each of these tasks is segregated such that each individual is responsible for a specific 'part' of the reporting duty, whether due to the legislation (directly or indirectly) or the application of those legal requirements within the structures of the audit firms. The reporting protocols are reminiscent of the proverb: 'a place for everything and everything in its place' (E17).

Secondly, the APA achieves a 'temporal elaboration of the act' of reporting (Hopper and Macintosh, 1993, p. 195) aimed at creating a sense of order and control. The auditor must initially and 'without delay' inform the IRBA (s45(1)(a) of the APA, 2005). Following this – and no later than three days after the first report to the IRBA - the auditor must notify the client's management board in writing of the first report (s45(2)(a) of the APA, 2005). Thereafter the auditor must, no later than 30 days after the first report is issued, take reasonable steps to discuss it with the client's management board (s45(3)(a&b) of the APA, 2005) where after a



second report is issued to the IRBA to the effect that either: no irregularity has taken place; that the suspected irregularity is no longer taking place and that adequate remedial action is being taken; or that the irregularity is continuing (s45(3)(c) of the APA, 2005). Appropriate details ought to accompany the reports, a process 'simplified' and guided by 'templates' made available by the SAICA (2007) and developed in consultation with the regulator<sup>104</sup>. In the interim:

'You will have loads of documentation when you find an RI...It's very important to document our thought process step by step to say [sic] how you reached your conclusions' (E6).

'Our audit file is set up to take you through the process step by step. There are specific enquires that you have to make and put on the file first. Then, you look at the facts and make your own conclusion. Following that, there are formal consultation rules that have to be followed. You make sure [that this part of the file] is 100%' (E3).

In each instance, a clearly defined reporting protocol is designed to add to the procedural rigour of the whistle-blowing duty, promoting confidence in the process and ensuring official, clear and accurate reporting (Nel, 2001; IRBA, 2006; SAICA, 2007). What this ultimately achieves is a more 'general rendering' of whistle-blowing in a manner that most experts and users described as procedural, well-structured and rational and appealing to a sense of direction, control and efficiency. Interconnected with this is a 'rendering visible of certain activities in a way which is intelligible by virtue of certain general categories' (Miller and O'Leary, 1987, p. 240), in this case, the prescriptions of an Act of Parliament and guides provided by the regulator.

---

### 7.1.2: ON PRINCIPLES OF DISCIPLINARY POWER

---

Commenting on the rationale behind the RI provisions, interviewees referred to the relevance of surveillance, in line with the prior corporate governance literature stressing the importance of transparency and accountability (Brennan and Solomon, 2008; Roberts, 2009):

'I think that [s45 of the APA] is there to protect the public interest in that there is a monitoring mechanism overseen [by an independent regulator]' (U8).

---

<sup>104</sup> For details on the procedures followed when an RI is suspected or detected, refer to Section 2.1. An example of common RI's may be found in Appendix A4 and template reports that would be sent to the client and the IRBA are available in Appendix A6 to Appendix A8.

'From that perspective one could also say that there is definitely a policing element to [s45 of the APA]. In fact, I would go so far as to say that wanting to create a policing function was a key driver of the APA and its predecessor' (U9).

'If a company knows that there is a legal duty on someone...to check on them and to report if something goes wrong, they tend to be more responsible....they make sure that they dot the "i's" and cross the "t's", not because in the past they did not pay attention, but because they know that somebody is watching' (U3).

Users in particular reiterated how the traditional audit report is relatively generic, simply expressing an opinion on whether or not financial statements are in compliance with IFRS (Chapter 4):

'Section 45 of the APA may not necessarily have changed the way audit firms actually do the audit but it does at least give them a reporting duty which did not exist before...and that is good thing because although you are [an important stakeholder] you don't necessarily know what's going on detail by detail [sic]...Now the auditor not only has a duty to report on financial statements but to tell the audit committees and regulators that there are other issues as well' (U2).

The experts similarly suggested that the RI provisions expand the auditors' reporting duty, adding an additional monitoring function. In particular, descriptions of the RI provisions were reminiscent of a 'panoptic tower of experts' (see Hopper and Macintosh, 1993):

'From the perspective of the audit firms, there is definitely a surveillance element [to the RI provisions]. The State is expanding, or perhaps outsourcing, parts of its policing function. From their perspective, that makes sense: the auditor is very nicely placed to carry out the surveillance function' (E9).

'I think Government wanted to know. It's almost like they're making auditors their agents...because that is the only mechanism available to them...It creates a watchdog mechanism that gives more power. But then part of that is that you get information...so that you can hopefully avoid some of these spectacular failures' (U3).

'After all, who else is able to access all of the client's information without even having to get a Court order! The State could try and create another surveillance mechanism, but it would not be nearly as cost effective or efficient. So, what they have in audit is a very nice, efficient and *free* way of getting information' (U8).

'Especially since Government does not have the expertise, competency or capacity to carry out a detailed review. So they created this legislation [s45 of the APA] where [auditors] have to report just about everything' (E5).

Elaborating on exactly how auditors are 'nicely placed' (E9) to offer a window into the client:

'At the end of the day, the auditor is able to access any part of the organisation. This is something he is afforded in terms of the law. Notwithstanding the legal issues, the auditor can ask questions; examine the records; access all parts of the business; corroborate whatever he likes. [This] is basically what audit is all about. You don't even notice them [auditors] anymore' (U13).

'And then, when they [auditors] find something interesting, the different regulators [having been informed by the IRBA under s45(4) of the APA] can then send in their teams as necessary. And that is precisely what they do! The South African Revenue Services are a perfect example of this. They have been using s45 [of the APA] to their advantage very effectively' (U9).

In this light, the APA derives its value not by virtue of imposing awful physical or severe monetary sanctions on a client's senior management. Instead, it affords a means for regulators to 'gaze' into the organisation at a moment's notice and at considerably little cost to them. The interviewees did not describe *actual* surveillance or observation. The auditors do not enjoy the physical optical advantage envisaged by the Panopticon. Instead, monitoring becomes more subtle, involving written accounts in working papers and the auditor's information systems, capable of analysing information and producing reports on each financial aspect of the organisation. Resulting visibility is not derived from calculative approaches evaluating deviations from the norm statistically but rather from normative assessment in terms of the discourse of auditing, now including the RI provisions.

The auditor's ability to access any part of the organisation for the purpose of collecting audit 'evidence' for review by an experienced audit partner heightens the sense of visibility. Further, the underlying audit process is regarded as a natural and inevitable part of everyday business life (see also: Watts and Zimmerman, 1983; Power, 1994) such that the auditor's activities go virtually unnoticed (U13). In this way it becomes difficult for the observed to determine whether or not he is subject to actual surveillance. In contrast, by virtue of the RI provisions, regulators gain a window into the organisation and an ability to act on reports released to them by the

IRBA as they deem fit, making the auditor part of a complex surveillance system at least similar to a 'panoptic gaze'<sup>105</sup>.

In addition the ISA specifies the use of appropriate sampling techniques (IAASB, 2009p) incorporating a degree of unpredictability in the planned audit approach (IAASB, 2009g; IAASB, 2009m). This ensures that testing is, to some extent, random and unexpected. When it comes to RI's, although the auditor is not required specifically to perform procedures to detect them (IRBA, 2006), whether or not a reporting duty is triggered is inextricably dependent on the extent to which auditors comply with ISA (PAAB, 2003; IRBA, 2006; IAASB, 2009h). In addition, when the auditor does suspect or detect the RI, he is required to inform the IRBA of the fact *before* discussing the matter in detail with the client (s45(2&3) of the APA, 2005; IRBA, 2006). Although the client may suspect that a report to the IRBA is imminent, once the report is issued to the IRBA, most respondents agreed that the client's management is neither aware of which regulator the report has been passed to nor the planned response (if any) by third parties. Several interviewees suggested this was a source of anxiety.

In this way the RI provisions are akin to a 'cadre of technical staff and product managers in... central headquarters' used by a CEO to complement a system of hierarchical surveillance outlined by Hopper and Macintosh (1993). In the respective audit firms, the relevant regulator has a single, contained unit (the audit team) that has the relevant skills and competency to process and evaluate a client's financial information, controls and financial statements. Just as Hopper and Macintosh's (1993, p. 204) team of senior managers may, 'without an invitation', 'investigate anything within their area of expertise', so the audit team also enjoys *carte blanche*. The result in a management control context is close association between hierarchal surveillance and 'normalization' of behaviour reinforced by processes of 'examination' (Walsh and Stewart, 1993; Cowton and Dopson, 2002). A similar situation may hold in the context of the RI provisions where surveillance - reminiscent of a 'panoptic gaze', may be working on the minds of an audit client's senior management. Interviewees explored this possibility from the perspective of a company's board of directors. They explain how the legislation may be focusing specifically on senior officers of an audit client with an aim to stressing accountability, in line

---

<sup>105</sup> What makes panoptic metaphor particularly powerful is that the motives of the 'watchers', as well as their identities, are not known to the observed (Gordon, 1980; Smart, 2002). Panopticism relies heavily on 'temporary, anonymous observers' which naturally piques anxiety and further motivates the desire to 'normalise' behaviour (Hopper and Macintosh, 1993, p. 203).

with the prior literature on management control systems (see, for example, Walsh and Stewart, 1993; Cowton and Dopson, 2002):

'The directors....are effectively being policed. I don't want to get into the technical details, but [s45 of the APA] is really being aimed at the senior management of the company. Those are the people who are ultimately responsible for the governance of companies and so, stakeholders might need to be made aware that [their governance-related actions] [Section 45 of the APA] is one mechanism by which that is done [sic]' (U9).

Elaborating on the issue of enhanced transparency in the name of stakeholder engagement being in the public interest (IOD, 2009; Solomon, 2010; IRC, 2011),

'One reason for the [reporting duty] being in the public interest is because the affected companies are subject to monitoring. At very least the senior individuals of the company are being monitored' (U10).

'In an ever more complicated and integrated world, regulation becomes unavoidable' (U6).

'The RI provisions are one of the mechanisms that is there to protect the public interest....At least the Government has a way of finding out what's going on in companies and letting people know that they had better be aware that someone is monitoring them. Part of this is probably about preventing new failures by tightening people up [sic]' (U8)

Another interviewee highlighted the effect of this monitoring:

'I know that [the reporting duty is there] and it would worry me' (U2).

Anxiety and worry featured heavily in the interviewees' views of the RI provisions which would 'work on the minds' (E3, E6) of a company's senior managers and directors, thus engendering self-discipline (Roberts et al., 2006):

'...First we have the machinery that allows for [disciplinary sanctions]. Second, this is being run properly and that this works on them to put in their energy and commitment [sic]' (U6)

'You need...to be a good corporate citizen, and if you don't, there is someone who is going to come in and have a look and might report you. I think that is the sort of reasoning. You return to the fact of people have to have an audit and now [the auditor] is reporting if these people are doing something illegal. And that probably makes people more cautious. They are more concerned about being in compliance and getting things right the first time' (U10).

'When the auditor submits his documents, including the letters and explanations that have been given to him to the IRBA, that can make people nervous - the directors, for example. I think that audit clients definitely feel the effect of having this thing [the reporting duty] hanging over their heads' (U7).

Elaborating on the idea of 'having something over their heads', interviewees explained how audit becomes akin to an examination process (consider Hoskin and Macve, 1986). Audit, as discussed in Chapter 6, has been accepted as a natural and necessary form of policing or monitoring (Power, 1994; Humphrey, 2012). In its traditional sense, audit includes a host of procedures performed to evaluate defined subject matter, usually a set of financial statements, against a 'suitable' framework, often IFRS (IAASB, 2009c; IAASB, 2009l; IAASB, 2009k; IAASB, 2009m). Section 45 of the APA complements this. In addition to the audit report on financial statements, the auditor becomes obliged to report certain acts regarded as inconsistent with societal norms, and effectively contrary to the public interest (Nel, 2001; IRBA, 2006), to an independent regulator. In this way, the RI provisions becomes part of moral assessment (U2; U10; Nel, 2001) of the client's management board with the auditor considering whether 'acts' or 'omissions' result in material loss to third parties; are indicative of a material breach of fiduciary duty; or amount to fraud (s1 of the APA, 2005; IRBA, 2006; PwC, 2006). In each case, the client's management board is open to sanction from the relevant regulator.

The risk of sanction dependent on the outcome of the auditor's 'procedures', is described by users as a 'weight' hanging above the individual director's head. By virtue of application of technical procedures (Power, 2003; IAASB, 2009c) by independent and competent professionals (Edwards, 2001; Carrington, 2010), several respondents explained that any report issued to the IRBA becomes tantamount to an expression of opinion on the client's management board or the reduction to writing of a fundamental, and potentially damaging, 'truth' which could be used at a later stage by a regulator wanting to take corrective action. Foucault (1977) explains that one outcome of subjection to examination and hierarchical surveillance may be normalization<sup>106</sup>. Considering the reporting protocols of the APA, a similar view emerges. After the first report is issued to the IRBA, the auditor is obliged to take reasonable measures to discuss the report with the client's management board before a second report is issued to the regulator (s45 (2&3) of the APA, 2005; IRBA, 2006). When this second

---

<sup>106</sup> In *Discipline and Punishment: the Birth of the Prison*, Foucault does not conclude that examination, hierarchical surveillance or disciplinary power results in rehabilitation of the 'criminal'. He simply points out that this is a commonly held belief (Gordon, 1980; Smart 2000).

report is sent, and assuming that an RI has been detected, the auditor is specifically required to comment on whether or not the RI is continuing and if 'adequate steps have been taken for the prevention or recovery of any loss as a result thereof'<sup>107</sup> (s45(3) of the APA, 2005).

Interviewees concluded that where an RI was detected, it was clearly the intention of the legislature that there be an 'incentive' to remedy the RI. The auditor is not at liberty to report unless the RI is not corrected (Wielligh, 2006) and may not allow the client the opportunity to take remedial action to avoid at least notifying the IRBA (IRBA, 2006). Nevertheless, the client is informed of the first report having been sent to the IRBA and is effectively given a 30-day 'deadline' (E13) to deal with the issue to ensure that the second report concludes that either there is no RI or that it has been corrected in order to avoid the report being escalated to the relevant regulator (E12, E11). In this way, 'visibility' achieved by immediate reporting by the auditor to IRBA works hand-in-hand with the potential imposition of sanctions to achieve 'normalising behaviour'. Further, commenting on the nature of issues reported to the IRBA, audit experts in particular, highlight that the frequency of relatively administrative issues being reported to the IRBA has reduced considerably as companies respond to the risk of non-compliance being reported to the relevant regulators. For instance:

'Not having a fixed asset register is a common example of the sort of administrative (and relatively trivial) issue that was traditionally being reported to the IRBA. As far as I am aware they [the IRBA] have not seen one of those for a long time. Obviously, companies are now preparing fixed asset registers. Companies have been made aware of the fact that they need to move things along – that they need to comply with the basics' (U3).

From this perspective, the issue of reputation is also relevant. Echoing the work of Brivot and Gendron (2011) and Walsh and Stewart (1993), the risk of being branded delinquent for non-compliance is an important part of the reward and punishment system underpinning disciplinary power (Gordon, 1980; Moore, 1991; Hopper and Macintosh, 1993). An RI could be tantamount to a 'scarlet letter' (U11), highlighting the company as non-conformist in the eyes of regulators and other stakeholders. Even when reported issues would not otherwise have been regarded as material, interviewees suggested, 'If they can't get the basics right, what else could be going wrong?' (U3)

---

<sup>107</sup> This line of thought is common in a management accounting context where Hopper and Macintosh (1983) Cowton and Dopson (2002), Miller and O'Leary (1987) and Drury (2005) point to the potential of management control systems to define 'calculative norms' or standards to which individuals are expected to strive.

Just as the use of coloured markers - which rendered the performance of individual factory workers visible to managers and peers - was used to motivate improved productivity in the 18<sup>th</sup> century factory (Walsh and Stewart, 1993), the concern about being 'identified' as 'getting even the basics wrong' (E16) or being 'branded' as non-compliant has a disciplining effect on at least some senior managers. Contemporaneously, disciplinary power manifests itself subtly, often working on those areas of life otherwise ignored or undefined (Foucault, 1977; Miller and O'Leary, 1987; Moore, 1991). Section 45 of the APA, was described by almost all respondents as an example of whistle-blowing that could bring *material* transgressions into the open (Nel, 2001) and creating a sense of improved transparency (Chapter 6.1). This move is fully consistent with the stated objectives of the regulator (Nel, 2001) and the essence of codes of corporate governance (see IOD, 2009; Solomon, 2010). The legislation, however, also results in the divulgence of what may be termed 'housekeeping issues' (E1)<sup>108</sup>. Whether intentional or otherwise, respondents noted that: the requirement for any act of fraud to be reported; a failure to define clearly what 'breaches of fiduciary duty' actually means; and the examples of 'reportable acts' provided by the IRBA's guidelines (IRBA, 2006), results in a plethora of reports issued to the IRBA, many of which may not deal with highly material incidents<sup>109</sup> (Wielligh, 2006). The result is that 'housekeeping issues'- otherwise 'beyond the interest of regulators and the prosecuting authorities' (E16) - become a focal point for the whistle-blowing duty, together with 'irregularities' which would have material implications for different stakeholders (E1, E3, U3). What is important from the perspective of disciplinary power is that 'a new layer of supervision develop a system of "normalising sanctions" which move into spaces of indifference' and not generally focused on by the State (Hopper and Macintosh, 1993, p. 200).

---

<sup>108</sup> 'Housekeeping issue' is a colloquial term frequently used by auditors to describe an issue noted during the course of the engagement which does not have a material effect on the financial statements, a client's internal controls, or its annual report. These are often administrative or immaterial compliance issues.

<sup>109</sup> Unlike its predecessor - which placed emphasis on irregularities being material - the RI provisions are broader, particularly when it comes to the issue of fraud (Gawith, 2006; Wielligh, 2006). This 'improvement', as discussed in Section 2.1, marked an effort to address the risk of inconsistent application of the reporting duty due to the application of professional judgement and of circumvented reporting by rogue auditors (Nel, 2001; IRBA, 2012b). Whether intentional or otherwise, the effect was, as described by most experts and users, an increase in the number of reports issued to the IRBA, many of which would not have been reportable under the PAAA (Wielligh, 2006; IRBA, 2012b).



---

### 7.1.3: AN EXPANDED SENSE OF SURVEILLANCE

---

The 'disciplinary potential' of the RI provisions may work concurrently on both the client's senior management as well as the auditors. User 6 explains:

'The rules probably help [the IRBA] and the auditor because it's structured in a certain way. You know what the serious issues are; you know what's expected and when; and you end up with consistent reporting that avoids a million different interpretations...you can also deal with people who just don't want to report and with those who have reported but needed guidelines so that they know when they have to report' (U2).

'...does section 45 of the APA amount to creating a watchdog for the watchdog? That is exactly what it is aimed at! Who will watch the guards? So, [in that light] it is absolutely necessary, and as I say, I might sound like a disciplinarian, but I have seen just too often that there are some professionals who, funny enough, just don't take their work seriously' (U6).

Just as the preceding section argued that s45 of the APA achieved a sense of hierarchical surveillance over an audit client's senior management, a similar situation appears to hold when it comes to auditors themselves:

'Section 45 [of the APA] may not be changing the way that we do our audits but there will be instances when it focuses the mind' (E5).

'One thing that we have is a very strong consultation culture....you can't make calls on your own or decisions on your own any more' (E6).

'And so I think the legislation does have an impact. It definitely emphasises the role of the partner and makes you more aware... even if you would not have changed the way you do your audits' (E17).

There may also be sanctions for non-compliance with the RI provisions:

'Look, it [the possibility of a penalty for non-conformance] does focus the mind. Whether they are the right penalties or not is a different issue but they certainly focus the mind. So, if you are sitting and thinking: "nobody will ever know" [if you do not report an RI], you kind of have to think a bit more clearly [sic]. At the very least it creates a consultation even if it was just with a couple of partners' (U5).

When there is an RI, 'you have sleepless nights. At the end of the day, you have to report. You can't go on the fact that you might lose the audit. It's a real issue. A lot of people criticise audit because they perceive us as placing profits ahead of quality and that we want to keep the client happy. That's wrong – that's not how it works' (E7).

Importantly, the IRBA is not constantly observing the auditor but merely has the *ability* to make relevant enquiries by virtue of: powers of inspection (s47 of the APA, 2005); the requirements pertaining to investigations of improper conduct (s48 of the APA, 2005); and the mechanisms for holding disciplinary proceedings (s50 of the APA, 2005). For experts, it is the surveillance-potential of the APA which works on the mind of the audit partner, rather than the physical act of enquiry by the IRBA that is important. This observation-induced ‘anxiety’ (U13) is magnified by internal quality review requirements taking place at each audit firm (for more detail see IAASB, 2009x; IAASB, 2009e), a process which effectively contributes to the creation of a network of surveillance:

‘It is important not to look at s45 of the APA in isolation. Sure, the legislation does create a regulator that looks down on the auditor - auditors have the risk of inspection and disciplinary action for not complying with [the reporting duty] that becomes part and parcel of the whole quality review process carried out by the IRBA. But there is also the risk that the issue that they didn’t report ends up coming out on the evening news, in which case they are going to have a shit load of questions coming at them from all sorts of third parties. On top of that, auditors undergo regular *internal* inspections which would end up looking at whether or not RI’s are being dealt with properly to keep the [audit] firm’s risk to a minimum’ (E15).

Complementing this ‘surveillance network’ is an element of peer review. For example, Brivot and Gendron (2011) document how having one’s work rendered visible to others, coupled with the issue of being readily identifiable as non-compliant with set knowledge management policies works on the mind of individual professionals. When it comes to the RI provisions, it is the ‘individual’ partner (s44 of the APA, 2005) who is ultimately responsible for compliance with the APA and ultimately accountable and known to his peers:

‘At the end of the day, when it comes to reportable irregularities, the responsibility does not lie with a team member or the manager. It starts with you as the partner because you are the one signing off. So there is definitely a bigger sense of responsibility and the repercussions that will occur’ (E8).

As the individuals whose signature appears on the respective audit report or letter to the IRBA (Appendix A), experts, in general, highlighted a strong awareness of reputational risk, as also mentioned in Chapter 4 and Chapter 5. By virtue of the fact that the IRBA or audit firms themselves are in a position to carry out quality reviews at will, coupled with the risk that a failure to report an RI could later be exposed to third parties (U1; U10; E1), individual audit partners are rendered visible not only to regulatory authorities but to their fellow partners, staff and clients. Several respondents held this view, effectively echoing the sentiments of Brivot and

Gendron (2011) and Carrington (2010) on the importance of professional appearance. For example:

'I am a professional. I am proud of my firm. I am proud of my work. I have a duty to the people who work with me to make sure that we [discharge our professional duties] to the very best of my [sic] ability.... [I] also have a duty to my client... [I] take my work personally and so I have a sense of personal duty. I am also worried about the brand and reputation of my firm' (E5).

'...and at the end of the day...you don't just study seven years to become a Chartered Accountant just to forget about your [duties]' (E7).

'And so, when you realise that all you have as a professional accountant is your technical skill and your professional reputation, you have to ask if you are willing to have that shattered by not complying with the APA. Imagine the scandal if you did not comply with a statutory duty. Even if you didn't end up in jail, your name wouldn't be worth a thing. You would be finished. Everyone you work with, even your 1<sup>st</sup> year clerks<sup>110</sup> would know what you had done and would not be able to place confidence in you as a professional (E15)'.

By virtue of being the member of the team ultimately responsible for compliance with the RI provisions, the risk of non-compliance rests almost exclusively on the partner. While fines and imprisonment serve as deterrents for the delinquent auditor (U2; E1), what is simultaneously identified is the sanction against the very 'soul' (E9) of the professional by having him 'identified' as non-compliant with the APA and rendered fully visible to his subordinates and peers as operating contrary to the statute.

'Look, the [consequences for not complying with the RI provisions] are about showing the auditor a big stick. But the biggest part of this is not the jail or the fine. These are professional people. One day in jail, let alone 10 years, is more than enough to dissuade them... So what the [APA] does is provide the auditor with a kind of stick, **not in a physical sense**, but in the sense that, if you are wavering, you probably go with reporting. It does not change the way you do the audit but now that you have stumbled across [an RI] you are going to report it' (U1, emphasis added)

Rather than rely on physical punishment, surveillance works insidiously on the mind of the individual by making him visible, calculable and known (Foucault, 1977; Gordon, 1980; Smart, 2002). 'Visibility' is, in turn, made possible by the 'discursive' (Boland, 1987), structured and individualising (Hopper and Macintosh, 1993) practices in which the reporting duty is

---

<sup>110</sup> First year clerks are the most junior members of South African audit teams.

couched<sup>111</sup>. The result is that interviewees also alluded to an interconnection between visibility and normalizing sanction. The risk of fines and penalties, coupled with the possibility of being rendered 'visible' as a delinquent or non-complaint auditor, serves to motivate behaviour consistent with the 'norms' enshrined in the APA. From this perspective, the 'normalising' effect of disciplinary power is focused not just on the organisations and their senior management subject to audit. There is a real possibility that the RI provisions work on the mind of the auditor as much as they do on the minds of the auditee

---

## 7.2 DISCIPLINARY POWER AS A SOURCE OF LEGITIMACY

---

As discussed in Chapter 6, interviewees were unanimous that the South African Government was responding to corporate failures both locally and abroad in developing the RI provisions.

'My suspicion is that the APA was pushed through after a lot of [corporate] failures and the self-regulatory approaches appeared to be failing. But, to a large extent, Trevor Manuel's [Minister of Finance at the time of the promulgation of the APA] mood had a lot to do with it. He has a mood of: "well, I am going to show these accountants up". And that is what got under his nose when he started attacking the self-regulatory framework. I don't think he wanted to stamp total authority on the auditors, but he certainly wanted to move away from the self-regulatory approach. That was the mood he was in' (U4).

'The Minister warned the profession, at the time the Act was being discussed and finalised, that they had better "pull up their socks". He had no idea of what auditing was actually about but he was warning them anyway. The whole presentation<sup>112</sup> was definitely an effort at showing the profession that Government had the power to intervene and that they were watching the auditors' (U11).

As discussed in Section 7.1, disciplinary power is at work on the professional. Section 45 of the APA alters ideas of what it 'means to be an auditor' (E8) by creating a duty to bring certain transgressions to the attention of a regulator, over and above the traditional requirement to express an opinion on financial statements (Section 4.3). It renders individual partners 'accountable' (E8; E9; U10) for what users almost unanimously described as a whistle-blowing

---

<sup>111</sup> Foucault (1977) explains that while overt disciplinary sanctions remain a part of modern society, alternate punishments designed to reduce non-compliance included repetitious exercises (Hopper and Macintosh, 1993), the labelling of the individual as non-conformist (Walsh and Stewart, 1993) and challenging the technical capabilities of professionals (Brivot and Gendron, 2011).

<sup>112</sup> The 'presentation' referred to was a discussion on the then Draft Accountancy Profession Bill (2001) which later became the APA.

duty that has the potential to bring significant transgressions to the attention of stakeholders (Chapter 6). This bolsters confidence in the formal, rational reporting requirement and, simultaneously, notions of pragmatic and moral legitimacy. The end result is that s45 of the APA is reaffirmed as an example of external regulation that most regarded as a credible means of positively contributing to the South African corporate governance environment. For example, commenting on the change from MI's to RI's (Section 2.1):

'This was because of disciplinary issues. There was a perception that [the auditors] can't control [themselves] and that they weren't taking the MI's seriously enough. The aim of s45 [of the APA] was to try and address this and get the auditors to report more because that was seen as one way of improving accountability and compliance' (U14).

Further, on the relevance of consequences for the delinquent auditor under the APA:

'Does having a stick show that there are consequences? Does this make people more vigilant and thorough? ...I don't want to come across as a disciplinarian, but I certainly think it does.... (U6).

'Reassurances' are provided (E1; U10) that reporting under the APA makes practical contributions reinforcing elements of influence and exchange legitimacy (Suchman, 1995). Similarly, Section 2.3 pointed out that organisations are frequently evaluated according to their accomplishments and underlying procedures. That motifs of disciplinary power are inherent in the RI provisions implies that the RI provisions are 'real' (U1); that there are sufficient grounds for trusting in the reporting protocols (U14; E6); and, hence, that they provide a *bona fide* mechanism for effective, pro-social (Staub, 1978) whistle-blowing (U6). Likewise, the power of legal process and conceptions of the audit firm as 'well-placed' (U8; E9) to confer a sense of structural legitimacy (Section 4.3; Section 6.1) are enhanced by the fact that the RI provisions are prescriptive; try to limit the use of professional judgement; resonate with the ideal of rendering individuals 'visible' or more accountable; and carry consequences for non-conformance (consider Power, 1994; Roberts, 2001). This may be especially important in the context of South Africa's low audit litigation risk environment (consider, for example, Palmrose, 1988; Palmrose, 1997; Cousins et al, 1998; Cousins et al, 1999; Liao et al, 2013):

'Big legal cases in South Africa are also very far and few between. So, I'm not sure that [litigation risk mediates auditor behaviour]. So, disciplining them - having sanctions in the legislation is an important alternative...It's not sufficient to leave it open private litigation because, as I have said, private litigation in South Africa is not sufficient' (U6).

'In the South African environment, our legislative processes are very slow. Having an immediate financial consequence [referring to the fines for non-compliance with the APA], or knock to

professional standing for ignoring the APA, is probably where the motivation [for reporting] comes from' (U3).

The result is that,

'...there is definitely a sense of being watched, being accountable and of consequences for not reporting. And that's funny because nobody has ever been sued'<sup>113</sup>. There is a sense of: "I don't want to be the first one", but it's also about the fines, the jail term, the personal reputation. It's about the embarrassment...and this tells us that the reporting duty is probably taken seriously' (E6).

Similar processes seem to be at work on at least some senior managers at audit clients where an 'observation-induced anxiety' achieves panoptic-like control that heightens a sense of transparency and individual responsibility on the part of the auditee (Section 7.1.2). The result is an example of external regulation that most respondents regard as a realistic means of positively contributing to the South African corporate governance environment. As explained by Power (1994) and Pentland (2000), there has been a shift away from assumed trust in expert systems to one where transparency, accountability and control have become paramount (Unerman and O'Dwyer, 2004; Roberts et al, 2006). Section 45 of the APA 'meshes' with these expectations, achieving for auditors a sense of cognitive legitimacy in the process:

'If you do something wrong, it's got to be reported. That's why the RI's make sense' (U10).

'The auditor is closest to the client. So long as the monitoring is done correctly, it seems appropriate. You need to have people know that they are being reviewed and that there are consequences for their action. [In the absence of the RI provisions] you would have to employ a whole bunch of people who are not close to the client and then go and investigate. It comes down to the issue of there being a watchdog' (U3).

Stressing the importance of at least some type of monitoring function, several interviewees drew parallels between the USA promoting accountability and transparency with the use of external regulation - such as SOX and the Whistleblower Protection Act (1989) - and South Africa championing whistle-blowing through, *inter alia*, s45 of the APA (see also Ianniello, 2012, p. 151). For some respondents, the RI provisions are, therefore, perceived as a necessary (U10) and 'inevitable' (U6) *quasi*-police function aimed at enhancing corporate accountability and compliance.

---

<sup>113</sup> The possibility of elements of disciplinary power being part of a ceremonial process described in Section 6.2 is discussed in Section 7.3.

Finally, adapting the concept of mimetic isomorphism applied in an organisational setting can yield important insights for the relevance of disciplinary power inherent in s45 of the APA. As explained by Leon (2001, pp 3-4, cited in Brivot and Gendron, 2011):

'Surveillance always carries with it some plausible justification that makes most of us content to comply...The fact that the camera is installed in the bar or at the intersection in order to reduce rowdiness or road accidents seems reasonable enough... The advantages of surveillance for its subjects are real, palpable, and undeniable. We readily accept the point of it...'

If surveillance, normalising sanction, processes of examination and mechanisms for reward and punishment are integral to modern life, as theorised by *inter alia* Foucault (1977; 1983), Hoskin and Macve (1986), Boland (1987), Brivot and Gendron (2011), Hopper and Macontosh (1993), then the RI provisions may be achieving a sense of legitimacy by cultivating a whistle-blowing duty, backed by sanctions for non-conformance, 'under the umbrella of pre-existing taken-for-granted' (Suchman, 1995, p. 586):

'The whole regulatory environment in the world has changed. Maybe [s45 of the APA] is not about trying to keep up [with international developments] in a negative sense, but in a positive way, saying that this is something we have in order to stay on the same level...It also gives cynics a value-added perspective about audit... [and therefore] it may be a case of trying to build up the audit profession' (E6).

'...For a very long time, the audit and accounting professions in South Africa regulated themselves. I think that there was a conscious decision to move away from a system of self-regulation to follow the trend in the rest of the world which relies on laws backed by penalties' (U2).

'The fines and penalties are also something consistent with [other local and international laws]. I am a proponent of this parity. All of our markets should be at the same level' (U6).

South Africa's move towards more exogenous control of the profession to parallel similar international developments is an example of mimetic isomorphism aimed at securing legitimacy (Section 6.2). As a developing economy, maintaining a level of regulatory parity with developed markets on which South Africa is dependent for international capital is of paramount importance (Konar et al, 2003; Diamond and Price, 2012; King, 2012). Replication of sanctions for non-compliance along the lines seen in the USA's model (Riotto, 2008; Sy and Tinker, 2008) forms part of this. Explicit fines and periods of incarceration under the APA are not only about

compliance but are integral to signalling the credibility of legislated reporting requirements. Central to this is a perceived parity between the requirements and consequences for non-conformance found in the APA and comparable legislation whether in South Africa or abroad:

'Section 45 [of the APA] was definitely a case of keeping up with the Joneses' (U5). 'The Government wanted to show that it was bringing in laws backed by steep fines and promoting whistle-blowing, just like the USA was doing with SOX...Government also wanted to show that it had the power to intervene in the audit profession [as compared with other jurisdictions struggling with audit-related scandals]'(U11).

'Does s45 of the APA create a sense of being watched...that causes people to be more vigilant and thorough? I certainly think it does. This country's standard of compliance – I think it's first in the world...and, of course, the system (a legislative disciplinary system) creates the machinery for that' (U6).

Similar 'rationalisations' for the RI provisions are found in the Nel Commission's (2001) initial enquiries into, *inter alia*, the mandatory whistle-blowing duty. The conclusion that the RI provisions would operate in the public interest are partially justified on the basis of equivalent sanction-backed duties in several other countries, including France and Malaysia (E1; U11). Per DiMaggio and Powell (1983, p. 150), 'organisational structures increasingly come to reflect rules institutionalised and legitimated by and within' the social arena. By analogy, one of the reasons for the RI provisions being readily accepted by some interviewees as a source of auditor legitimacy is because it mirrors the international move from self-regulation as discussed in Section 6.1. Interconnected with this is the threat of fines and periods of incarceration for the delinquent auditor along similar lines to other legislation both in South Africa and abroad:

'Major legislation such as SOX and company law in the UK, EU and South Africa have traditionally relied on sanctions in one form or another for non-compliance' (U14).

'Punishment' for departing from accepted norms was cited by most respondents as well established in South African customs and law (see, for example, POCA, 1998; van Aswegen, 2000; FICA, 2001; IRBA, 2011). Accordingly, sanctions enshrined in s52 of the APA for failing to comply with the duty to blow the whistle are integral to cognitive legitimacy:

'If we think about our rules and regulations, what do we need for them to be taken seriously – punishment. If you do something that you shouldn't there have to be repercussions otherwise you end up with anarchy. That is what the APA is about. You have this duty to whistle-blow and if you don't do what you are supposed to, there are consequences. That is, in my opinion, why people take this legislation seriously – it has all the right "ingredients": a legal duty which seems to be in the public interest; an independent regulator; and, at least in theory, some teeth' (U14).



'But the shift to more arms-length regulation does not amount to much if the change in policy does not have any teeth. It's all very well and good to say that Americans have SOX and that their auditors have to report on control deficiencies and that our auditors have to tell the IRBA about reportable irregularities, so we are on par and, thus, everything is all right. Just having whistle-blowing on paper doesn't count for anything. Why then can we see value in s45 of the APA? Because the client knows that the auditor is watching him and because the auditor knows he is being "watched" by [others] - that if he does not blow the whistle when he ought to he could go to jail and, even if he doesn't end up in prison, everyone will know that he is a shit auditor' (E16).

Foucauldian motifs of power and control are effectively intertwined with the processes of mimetic isomorphism which saw a drive to more arms-length regulation in the name of preserving the South African Audit Profession's claims to legitimacy (Section 6.1). A sense of enclosure, efficiency, surveillance and normalising sanction are readily comprehensible traits of external regulation and by incorporating these into the whistle-blowing duty, the RI provisions become an important source of legitimacy. This should not, however, be construed as suggesting that the panoptic metaphor provides a complete account for why the South African auditor is compelled to blow the whistle on certain irregularities. On the contrary, total enclosure, efficiency of the body and hierarchical surveillance are unlikely to be achievable in practical terms (McKinlay and Pezet, 2010; Brivot and Gendron, 2011). While some aspects of disciplinary power may be evident and reflected in views on auditor legitimacy, the limitations of the 'panoptic gaze' - and the possibility of Foucauldian power being interconnected with ceremonial displays of legitimacy and control - should not be overlooked.

### **7.3: A CRITICAL PERSPECTIVE ON THE RI PROVISIONS**

---

Although the auditor is not obliged to seek out an RI actively, whether the 'reasonable auditor' would have detected an RI would be inextricably linked with how well the audit procedures described by ISA are executed (see IRBA, 2006; IAASB, 2009h). Nevertheless, Chapter 4 found that not all respondents were convinced that the RI provisions materially contributed to the quality of existing audit practices. A possible exception was the issue of auditor reporting where Section 4.3 discussed how auditors are now compelled by law to dispense with client confidentiality and inform third parties of transgressions that would otherwise not have impacted

the audit opinion. Even here, however, many respondents agreed that there is no guarantee that effective reporting always takes place.

Considering the RI provisions as a source of legitimacy this trend continues. While some respondents feel that the whistle-blowing duty makes a contribution to the standing of the profession (Section 6.1), others adopt a more critical perspective, pointing to possible window-dressing on the part of the legislature or the emergence of a legalistic mindset that does little to change audit practice (Section 6.2). These tensions stand in stark contrast with the illustrations of panoptic control courtesy of Miller and O'Leary (1987) and Hopper and Macintosh (1993). What these conflicting views highlight are the inherent limitations of the panoptic metaphor in explaining the case for s45 of the APA, including emerging resistance to the disciplinary potential of the RI provisions.

---

### **7.3.1: LIMITATIONS OF THE RI PROVISIONS: RESISTANCE TO PANOPTICISM**

---

In examining the effect of increased visibility created by management controls, Cowton and Dopson (2002, p. 206) identify 'considerable variation in the way in which [individuals] embraced...changed conceptions of performance' as well as differences in reactions to the introduction of panoptic-like controls. Contrary to the predicted 'normalisation' of behaviour against defined standards (Foucault, 1977; Miller and O'Leary, 1987), a 'variety' of responses highlights a form of resistance to panoptic control (Cowton and Dopson, 2002) limiting the effects of principles of the efficient body, enclosure and disciplinary power (Gordon, 1980; Smart, 2002). Variation in the response to whistle-blowing under the RI provisions may be interpreted in a similar light. In contrast to the view that the RI provisions were a valuable part of the external regulation machinery, some experts argued that:

'We are suffocating the client with over-regulation. We are being totally senseless, doing things just to comply with the rules. It doesn't make sense. It is not practically possible to follow the methodology that we are supposed to (E15)'.

'There is a very real risk that all that happens is just mindless compliance with the rules. All that may happen is that [auditors] find an RI and report it, not because they feel morally obligated, or believe that they will add value for shareholders, but because the [APA] told them to. What would happen if the same act told them to jump off a bridge? The sad thing is that some of them probably would' (E5).

Dealing specifically with how the IRBA considers the firm's approach to the RI provisions:

'If we look at the issues that are raised in the practice reviews [carried out by the IRBA], they are often a complete waste of everybody's time. But we have to go through the process because...it could end up at the IRBA's Disciplinary Committee. And I think that the IRBA goes about its practice review, to a large extent, by getting hung up on whether or not things are documented just to show that one came in and ticked the box' (E8).

These views highlight two interesting points. Firstly, the variation between conceptions of the RI provisions as a 'tick the box' exercise (E8) or 'waste of time' (E5) on the one hand and as an example of auditors serving as a proverbial watchdog on the other (Section 6.1), implies that panoptic control and disciplinary power inducing normalised behaviour is not totally achieved. The Panopticon is illusory (Gordon, 1980). Secondly, in response to an increased sense of 'visibility', individuals may seek to find new means of 'escaping' a perceived gaze (Gordon, 1980; Cowton and Dopson, 2002; Roberts, 1991). A compliance-based attitude where *adherence* to, rather than *internalisation* of, defined standards becomes the primary objective. Indeed arms-length regulation may do little to encourage prudential professional judgement (McMillan, 2004). Instead, it can enclose or restrict professional conduct through prescribed, and potentially rigid, laws (Konar et al, 2003; McMillan, 2004; Vakkur et al, 2010). The chosen *modus operandi* of the RI provisions was cited by several experts and users as cultivating an attitude of simple compliance where the application of the law, even if in the public interest, is reduced to conformance; to determining what is and is not allowed by the APA and the IRBA's (2006) guidelines on reportable irregularities (Section 6.2.1)<sup>114</sup>.

Accordingly, the RI provisions are not unanimously described as whistle-blowing genuinely enacted in the public interest (Nel, 2001; Manuel, 2002), but as a set of 'rules' which the practitioner simply follows to avoid reprisal. The reporting duty, thus, comes to be seen as

---

<sup>114</sup> According to Roberts (1991; 2001; 2009) a legalistic approach may evolve into a type of defence-mechanism in response to the individualising effect of control mechanisms.

something which is adhered to ‘just to comply’ (E5) and which induces an over conservative approach to reporting as auditors err on the side of caution and report to the IRBA, not because they believe such is part of their moral duty, but as a means of avoiding sanction under the APA<sup>115</sup> (U1; U8; U9). Dealing with how auditors may not have *internalised* the whistle-blowing duty as one in the public interest:

‘Obviously the auditors do not want to find an RI because it creates obligations for them and sours the relations with the client. It also requires them to spend a lot of time, and it’s difficult to recover the money... [Therefore], I don’t think that they are happy to find a problem. Every auditor is probably most happy when they go through an audit and nothing is detected and there are no problems’ (U1).

Similarly, contrary to the arguments of Section 6.1 that reporting duty is an integral part of the audit process whereby the auditor fulfils his ‘natural’ role as a ‘watchdog’ (U3; E10; Nel, 2001; Manuel, 2002):

‘Could [professional judgement be used to document the problem away? At the end of the day, if you look at the nature of the auditor, what we want to do is resolve issues. We often want to sit down with management and come up with the solution. But this legislation is not really saying to us: “let’s resolve the situation”<sup>116</sup>. It is saying to us: “tell someone that something has gone wrong” ...and so the legislation can work in the opposite way’ (E3).

The RI provisions ‘are like saying to someone: “I’m going to tell the police”... and, although the police haven’t actually been informed yet, that is the equivalent in the minds of the client....People don’t like that. In a way, there is a relationship of trust between the auditor and the client. Now, you’ve gone to someone else and told them what [the client] did – and without discussing this with the client first. Yes, logically and ideally it’s dealt with by telling the client that you had to do it because that’s what the law says...but there is a lot of emotion involved....it’s human nature....The client is going to come to you and say: “You are supposed to be *my* auditor and you are supposed to keep this information confidential and now you are not’ (U10).

---

<sup>115</sup> If the auditor fails to report an RI when he ought reasonably to do so, he faces a period of imprisonment, fines and professional sanctions (IRBA, 2006; Maroun and Gowar, 2013). On the other hand, if he reports a suspected RI when in fact no RI existed, he may run the risk of civil action by either a client or third party (IRBA, 2006). The auditor – faced with such a dilemma (Maroun and Gowar, 2013) – may very well choose to err on the side of caution and report to the IRBA given the fact that South Africa is – compared to the USA – a low litigation risk environment. The expected costs of reporting erroneously would likely be less than the costs of failure to do, assuming that such an omission became public.

<sup>116</sup> The auditor is required to report an RI without delay before discussing it with the client (Section 2.1). Furthermore, the auditor may not assist the client in resolving the irregularity to circumvent reporting (IRBA, 2006).

As an ultimate act of resistance, perhaps the RI provisions are simply ignored<sup>117</sup>? This is a reasonable outcome given the criticism that external regulation does little to address ethical concerns and underlying capitalistic pressures at work on the profession directly (Sikka, 2004; Pesqueux, 2005), especially for smaller audit firms with few resources to resist client pressures (consider McMillan, 2004; Wyatt, 2004; Pesqueux, 2005; Agulhas, 2007). For example, commenting on the requirement to report an irregularity to the IRBA without delay and before informing the client (Section 2.1.3):

'If the auditor reports 'you get a relationship problem immediately...so, to give you a chance to investigate and make proper decisions is absolutely vital. And that is not afforded by the provisions [which require the auditor to report 'without delay']...I don't have any problems with the concept of reportable irregularities but [the issue] needs to be material and it needs to be prolonged. You need to give the guy a chance to remedy the situation...I'm not saying that you must scrap s45 [of the APA] but [in its current form] it discourages following the letter of the law. I guarantee you that the average partner will first talk to the client before he reports' (U5).

'I would not rule out that partners are going to discuss the issue with the client first to make sure you have the correct facts. That may not be 100% in line with the legislation, but that is what has to happen on the ground. You don't want to report and then end up with problems on your plate because you didn't have all the facts' (E4).

Similarly, the implications of no longer reporting the matter to the regulator *only* if the irregularity is continuing after thirty days (Section 2.1.3):

'What I suspect most auditors normally do – and I know that it's not in line with the legislation – is that they either give the client a chance to fix something and report only if it does not get fixed or that the smaller issues get documented away' (E9).

'Ultimately, do these things get swept under the carpet? I don't know. **Hopefully** not. **Hopefully** there are no partners that do that but one cannot be 100% certain' (E7, emphasis added).

A similar outcome is seen in the case of 19<sup>th</sup> century factory workers refusing to submit to managerial monitoring by revolting against completing time sheets (Hopper and Macintosh, 1993; Cowton and Dopson, 2002). Auditors may, likewise, not follow strictly the provisions of s45 of the APA or, at the extreme, may simply ignore their whistle-blowing duties:

---

<sup>117</sup> This may not be an exaggerated claim unique to RIs. Sikka (2009), for example, argues that auditors, seeking to champion the interest of their clients, have shown an increased propensity to disregard legal requirements (Chapter 8).

'But thinking about the auditors that I have come across, they all seem to be ethical and believe in the audit process. There will always be a handful that will be a problem...but I think auditors are nervous about not reporting' (U7).

'How do we know that if the auditor finds a reportable irregularity he actually reports and doesn't just ignore it? You would only know that by default. But I would think that that is very unlikely because of the very nature of auditing. The auditor would, in effect, be putting his personal position at risk for the client because if he didn't report the RI it has not only a potential financial consequence, but a clear reputational and professional consequence as well. So, the stakes are high. This is not simply monetary – the stakes are high because it's personal' (U1).

As discussed previously, the risk of being branded a delinquent auditor serves as a significant form of 'punishment' for the individual for whom professional appearance and standing are paramount (consider Edwards, 2001; Carrington, 2010). This is reinforced by penalties imposed by statute (IRBA, 2006). Accordingly, auditors 'probably don't' simply disregard the RI provisions (U1). Although they are 'not happy to find a problem' (E3), the risk of failed audits, damaged reputations, and possible intervention by the IRBA were cited as sufficient deterrents to circumventing the reporting duty:

'The fines, the penalties, and also the humiliation, that happens from not reporting – this is going to make sure that you, as the partner, are going to report' (E7).

'The consequences of not [reporting] are just so severe and onerous for us that I can't imagine any partner refraining from reporting' (E8).

'In the long-run, these things [not complying with the APA] come out anyway' with the result that 'the ramifications [of non-compliance] would just be too severe' (E3).

Other interviewees were, however, not as confident:

'At the end of the day, unless the auditor is extremely unlucky, it's very difficult for the IRBA to know whether or not the auditor detected a reportable irregularity but failed to report it' (U9). As a result 'I think that they [auditors] do probably find things that they don't tell us' (U8).

Ignoring the reporting duty may be a rational form of resistance to disciplinary power inherent in the RI provisions because of the illusory nature of panoptic control (consider Foucault, 1977; Gordon, 1980; Smart, 2002). The reality is that audit remains a process driven largely by the application of technical standards involving professional judgement by a closed audit team (IAASB, 2009c; IAASB, 2009k). Technologies allowing the auditor to record every piece of

evidence collected during the engagement (IAASB, 2009f) or for the IRBA perpetually to monitor auditors are not available. As argued by Power (1994; 2003) the audit process remains opaque making it impossible for persons outside the audit team to observe every aspect of the audit's execution and evaluate the conclusions reached:

'The legislation cannot force you [to report]. If I wanted to, I could very easily [justify not complying with s45 of the APA] by saying that I missed it, or that I forgot, or that I didn't see it. How could the IRBA even find out' (E13)?

'Now you may say that the legislation is not aimed at the ethical partner but at less "gutsy" people. But would they report an RI anyway just because of some Act? We need to stop being idealistic. If you really don't want to report, you can find ways and that there is an Act with penalties in it doesn't mean much because you will almost never be able to find out how many RI's there really are and how many got swept under the carpet' (E16).

There may also be an element of self-preservation (Roberts, 1991; Roberts, 2009) whereby disciplinary controls become reflexive, leading to the very problem that external regulations sought to address at inception. The elimination of the thirty day window before reporting to the regulator and the requirement for fraud, irrespective of perceived materiality, to be divulged (Section 2.1.3) were introduced to overcome the application of professional judgement or rogue auditors circumventing the whistle-blowing obligation (Nel, 2001). Paradoxically, given that the RI provisions do not achieve total panoptic control, the fact that the auditor may ultimately offend (and thus lose) a client due to blowing the whistle could lead to a process of reflexivity whereby auditors dispense with the RI provisions in the name of self-interest:

'You don't want to lose a client. You are in the business of making money. Now the duty to report to the IRBA can cause you to lose the client. And I think that that is one of the reasons why I don't think that [every audit firm] reports every issue' to the IRBA (E9).

'The legislation aggravates the tension between reporting and managing the client relationship that could undermine the desire to report...I don't have a problem with the concept of reporting irregularities and making it public....but [the current requirements of the APA<sup>118</sup>] discourage following the letter of the law. I will guarantee you that the average audit partner will first talk to the client before he reports, even though he, strictly speaking, is not supposed to' (U5).

---

<sup>118</sup> The respondent is referring to the requirement to report an irregularity to the IRBA without delay and before informing the client.

'It's not always practical to follow things verbatim' (E2). 'The legislation aggravates the tension between reporting and managing the client relationship... I will guarantee you that the average audit partner will first talk to the client [even though the APA precludes this] before he reports' (U5).

Several interviewees elaborated on the issue of compliance with the APA from an auditor's perspective:

'When you look at a reportable irregularity you look at it from two angles. You look at it from the perspective of not reporting and then facing penalties or you are going to report and face the risk of being sued by the client' (E6) or 'maybe even lose the client' (E10).

'So, do auditors, because of the additional reporting duties, added admin, and the risk of losing the client or being sued, just look the other way [when it comes to complying with s45 of the APA]? Look - that might cross your mind. Those auditors would just 'have their own conscience to deal with' (E7).

'After all', there are always some auditors 'who don't take what they do seriously' (U6) and, 'try as you might, you can't regulate ethical behaviour; you can't force people to do something even if it is – at the end of the day – in the public interest' (U13).

These views should not be construed as implying that the RI provisions are completely irrelevant or that Foucauldian notions of power are fatally flawed. Instead, what they highlight is the complex interconnection between power and resistance to power (Malsch and Gendron, 2011; Tremblay and Gendron, 2011). Notions of enclosure, efficiency and surveillance illuminate only part of the operation of the RI provisions. While these are reminiscent of Foucauldian notions of disciplinary power, 'not all empirics fit neatly into Foucault's model of analysis' (Hopper and Macintosh, 1993, p. 210). The model does not account for variations in the perception of the reporting duty. Contrary to the operation of a measure of normalising sanction, the mindset of auditors concerning whistle-blowing on their clients is far from homogenous. Elements of resistance are present and characterise the operation of the legislation, similar to the findings of Hopper and Macintosh (1993), Cowton and Dopson (2002) and Brivot and Gendron (2011), albeit in a non-audit context. At the extreme, limitations of disciplinary power – coupled with self-preservation (see Roberts, 1991; Roberts et al, 2006; Roberts, 2009) could undermine reporting to the IRBA and dilute intended regulatory effects (see Sikka, 2009; Tremblay and Gendron, 2011). The attest function continues to be characterised by application of technical standards and professional judgement (IAASB, 2009c; IAASB, 2009k; IAASB, 2009l; IAASB, 2009m) which render it opaque (Power, 1994; Power, 1997) and make it impossible for surveillance mechanisms to achieve total panoptic control. This implies that some aspects of power and control are evident and do provide for a certain



degree of behaviour change in clients and their auditors. To some extent, however, an increase in transparency and accountability due RI provisions may be taken for granted.

Respondents, however, remained confident that even though s45 of the APA (and its associated sanctions for non-compliance) do not discipline the mind of every auditor or senior member of a client's management, the legislation remains an important part of the audit regulation landscape. In particular, they pointed to the possibility of merely an appearance of disciplinary power being integral to the legitimisation-potential of the legislation. It may be possible that belief in an 'all-seeing' surveillance network is a significant part of the 'ceremonial process' of audit regulation and legitimisation discussed in Section 2.3 and Section 6.2.

---

### **7.3.2: FOUCAULDIAN MOTIFS CONTRIBUTING TO CEREMONIAL DISPLAYS OF LEGITIMACY**

---

If opacity of audit is a material source of legitimacy for the institution of auditing (Section 2.4), how can this be reconciled with the drive to render audit more transparent, as discussed in Section 7.1? With panoptic control possibly illusory (Gordon, 1980; Smart, 2002), this contradiction may point to a complex process of decoupling similar to that discussed in Section 6.2. Elements of disciplinary power may not be valuable solely as a means of reinforcing a pragmatic and morally sound whistle-blowing duty but also in reinforcing the myth that the regulation contributes to the legitimacy of audit and that Government has 'everything under control' (see also Unerman and O'Dwyer, 2004):

'The [RI provisions] have zero effect on the client. Maybe there is probably 0.5% of the business community who know who the IRBA actually are. For the [majority of businessmen]...it's just another acronym. They don't know what [the IRBA is] or [RI's] are and they probably don't care. As a result, the legislation [s45 of the APA] can't possibly generate an actual sense of surveillance on the client. A sense of power is just created because they've created a regulatory structure that audit is forced to comply with and part of that is being able to show how you can send someone to jail or give them a fine or take them to a disciplinary at the IRBA if somehow they find out you did not comply. But no-one is sure how this would happen. It's bullshit. It's all smoke and mirrors' (E5).

'On its face, it looks like the [RI provisions] are about surveillance (and maybe a response to Enron) but the big issue for me is what the IRBA does with those reports. They probably don't have the capacity to deal with all of them. They probably don't have the business acumen or detailed knowledge of the facts to do anything. It's just another judgement call and how do you make that call if you are far away from the client?...People need to come and show me the evidence. It seems to me that the biggest thing is just that the mechanisms and the penalties are there – just another control on paper to make it look like there are repercussions. How many auditors are in jail? None!' (U5).

The surveillance element of the APA derives some of its value, not by virtue of its actual disciplinary-power potential (Foucault, 1977; Gordon, 1980), but rather due to the legitimacy inherent in the *appearance* of a surveillance protocol. Based on the work of Suchman (1995), Meyer and Rowan (1977) and DiMaggio and Powell (1983) incorporating an element of surveillance, generally accepted as 'undeniably plausible' (Konar et al, 2003; Brivot and Gendron, 2011), may allow the RI provisions to internalise legitimacy based on the illusion of a disciplinary-power apparatus (Section 7.2). In the process, the whistle-blowing duty may add to the credibility of external audit, simultaneously reinforcing the cognitive legitimacy inherent in the good faith assumption that attest function operates as an important monitoring system (consider Hopwood, 1990; Power, 1994). Reiterating this view, Power (1994) and Pentland (2000) point to a growing sense of distrust that necessitates an increased role for audit as a means of improving perceived transparency and accountability (Roberts and Scapens, 1985). As discussed in Section 2.3 and Section 2.4, when the audit profession is itself beset by a crisis of trust, creating the *appearance* of additional control over the profession (backed by motifs of disciplinary power) is one means of preserving the credibility of the attest function and its ability to reassure non-experts of the reliability of financial reporting and of investment markets in general (see also Unerman and O'Dwyer, 2004).

As was the case in Section 6.2, the technicalities of the RI provisions are overshadowed by complex ceremonial processes. Practical difficulties encountered by either auditors, when adhering to the whistle-blowing duty, or the regulator, when trying to enforce it, are overlooked. These inherent shortcomings are decoupled from the image of a more regulated trustworthy profession by virtue of a power-control discourse. Likewise, a paradox of trust (Section 2.4): that the only reason for additional regulation to ensure continued trust in the profession is

precisely because trust itself is weakened, is also 'disconnected' from the assumed role of the RI provisions in South African audits<sup>119</sup>:

'We can **definitely place our trust** in the auditor...If you are a public person and you know that the auditor is going into the entity [sic]...and you know that they have this requirement [the duty to report RI's], I would feel a lot more secure in that anything bad will probably come out. And there is a problem if it does not come out [a reference to sanctions for non-compliance with s45 of the APA] and subsequently it is found that the auditor should have reported it' (U7, emphasis added).

'Trust is important. Why do we have trust in [whistle-blowing by auditors]? There is a very explicit obligation for the auditor. It's not something that the auditor can overlook because of the independence perspective and because of the financial, statutory and professional implications [referring to the consequences for failing to adhere to the APA]...Now **there is no question**, because there is a massive penalty, that they are going to report [irregularities]' (U3, emphasis added).

For complex organisational, corporate or financial systems to function, an innate or taken-for-granted 'trust' in their operation is needed (Giddens, 1990; Giddens, 1991; Unerman and O'Dwyer, 2004). Foucauldian displays of power and control contribute to this. They reassure stakeholders that 'normalised' behaviour will ensue after prior failures. By contributing to a discourse of 'control' and 'remediation', motifs of disciplinary power inherent in the RI provisions appeal to individuals at a subconscious level, cultivating a confidence or 'trust' in the underlying capital systems which, in contrast, have not materially changed (Chapter 4; Chapter 5). Ironically, overt displays of power and punishment might have been less effective, making the tension between trust and the need for regulation obvious and allowing processes of reflexivity to result in a complete withdrawal of trust from financial markets (Unerman and O'Dwyer, 2004; Black, 2008). A delicate balance is, therefore, needed between managing claims to auditor legitimacy and acknowledging that prior shortcomings need to be addressed. By doing so, the apparatus of surveillance, normalising sanction and examination can be brought to bear on both the auditor and auditee, allowing regulators to win the confidence of stakeholders in the process (Section 7.1). In line with the arguments of Guenin-Paracini and Gendron (2010), the mere appearance of 'punishment' of the auditor allows for the re-establishment of legitimacy and trust:

'You could very well end up with a situation where the partner goes to jail for not reporting an RI for longer than the perpetrator of the fraud in question. This is because of the public interest involved. Having these disciplinary mechanisms shows the public duty that the auditor is expected to fulfil. We have an improved sense of confidence in our auditors because of the consequences for the

---

<sup>119</sup> Special thanks must go to the participants and anonymous reviewers at the International Corporate Governance Conference (2012) for their comments in this regard.

delinquent auditor. The overriding requirement is the integrity of the market which is why you find such strict controls' (U6).

'And one of the reasons for us to place our trust in what auditors are doing with RI's is precisely because they have now assumed these extra duties and accept that they will be responsible for non-compliance – that they may end up in jail, or before the Disciplinary Committee or with a hefty fine' (U13).

The *appearance* of Foucauldian discipline and control is sufficient subtly to restore a sense of order (see also Guénin-Paracini and Gendron, 2010). With ideals of discipline and punishment already integral to and generally accepted by modern society (Gordon, 1980; Brivot and Gendron, 2011), technical anomalies are easily overlooked (Meyer and Rowan, 1977) such that motifs of discipline, punishment and legitimisation come to 'partake of the same process of mythification' (Guénin-Paracini and Gendron, 2010, p. 155). In this context, users were largely content to rely on the message: that there is this whistle-blowing duty backed by inspections, independent regulators and the force of law that serves the public interest. Emphasising the apparent benefits of the RI provisions is the ascendance of external regulation (Malsch and Gendron, 2011; Tremblay and Gendron, 2011), as discussed in Section 2.3 and Section 6.2.2. On the one hand, the popularity of external regulation and the 'natural' acceptance of punishment for non-compliance on the other would suggest that mandated whistle-blowing duties backed by fines and penalties are readily aligned with regulatory practice already enjoying a measure of cognitive legitimacy. The 'ceremonial myth' – in this case the general belief in auditor regulation as an example of a disciplinary power in action – is exalted (consider: Meyer and Rowan, 1977; Power, 1994; Suchman, 1995; Power, 1997; Roberts et al, 2006; Gumb, 2007). In the meantime, reality remains largely unchanged (consider Kaplan and Ruland, 1991; Unerman and O'Dwyer, 2004; Pesqueux, 2005). As explained by Meyer and Rowan (1977, p. 357) although inconsistencies and practical difficulties remain, a motif of disciplinary power means that 'the assumption that formal structures are really working is buffered from [those] inconsistencies'.

This 'buffering' is important because, to be decoupled from the ceremonial value of s45 of the APA's disciplinary power, it is important that individuals 'be left to work out' technical interconnections and resulting contradictions informally' (Meyer and Rowan, 1977, p. 357). What ultimately allows the RI provisions' notion of disciplinary power to win the confidence of a majority of users is the 'good faith' of those constituents, derived from the formal structures and

logical reporting method at the heart of an institutional approach to whistle-blowing, as discussed in Section 6.2. In essence:

'Delegation, professionalization, goal ambiguity, the elimination of output data, and maintenance of faith are all mechanisms for absorbing uncertainty while preserving' the ceremonial process and decoupling it from underlying technicalities (Meyer and Rowan, 1977, p. 358).

Highlighting this goal and output uncertainty inherent in the RI provisions:

'The audit firms certainly don't tell you how many RI's they reported; how many were administrative; how many were useful; and how these were resolved by the different regulators. There is no reconciliation that shows *how* these things [RI's] get dealt with which is made available. Sure, independence and client confidentiality is one thing. But the firms – and I am not just talking about the Big 4 – don't want to disclose this because they may get a reputation for being too strict when it comes to reporting; or because of the opposite; or because they don't want us to see that s45 [of the APA] may really be a waste of everyone's time' (E14).

'There is nothing wrong with the principle of whistle-blowing. The problem is that the IRBA does not seem to deal with it. What are the actual consequences of reporting an RI? Consider the following: 'the CEO has stolen something and I tell him: "I am going to report you to the IRBA". Now, if he turns around and says: "so what?". What will I answer? I don't know' (E5).

'And the irony is that this section would not have stopped something like Enron. The old regulation [s20(5) of the PAAA] was no different.... [The auditors] knew what was going on [at Enron] and should have reported it but they didn't.... I am not so sure if just having a piece of legislation would make any difference' (U5).

'So the question is: so what? What happens to the RI's? We don't get told. If you report an RI to the IRBA, we don't know how they are handled and what the processes are. All that we [the profession] have are some very general statistics about how many RI's were reported<sup>120</sup>. There has been no research on RI's - why we should report them and what the benefits are. In fact, you [the researcher] are the first person to ask questions about the RI's' (E2).

These views should be juxtaposed with those of the majority of users<sup>121</sup> who perceive that the reporting duty – because it is part of the professional auditing process – continues to have an important disciplinary effect:

---

<sup>120</sup> The researcher's request for details on the nature of each RI was declined by the IRBA on the grounds of confidentiality.

<sup>121</sup> This was one of the only instances where users and experts had materially different views on the RI provisions arising mainly from the fact that users, even though subject experts, are not privy to the actual processes by which RI's are reported and dealt with by the IRBA. This confirms the findings of Power (1994) and Humphrey (2008): that certain aspects of audit cannot be observed by outsiders.

'The RI's definitely create a surveillance effect...The client thinks, or at least feels, the he is sort of being surveyed [sic] by the auditor and the underlying regulatory mechanisms. Does this also apply to the auditor? Does he feel like he is also under surveillance? I would think so' (U2).

'And if we think of alternatives to the auditor, as a professional accountant, would they be viable?' (U9).

'I would like to see a court of law actually police the reportable irregularity provisions – actually look at it realistically. I don't think that they have the resources and the skills to do it, certainly not at the same level as the IRBA and the audit profession in general' (U6).

And from the auditor's perspective, '*obviously*, the auditor will not throw his career away and face a period of incarceration by taking a risk and not reporting [an RI] when he knows he ought to' (U12).

Reinforcing the arguments presented in Section 6.2, the potential for surveillance, examination and normalising sanction becomes an integral part of a complex ceremonial process whereby – even though the technicalities of audit are left unchanged – the belief that the RI provisions contribute to the standing of the profession remains. This is especially the case for users who, being unable to observe directly the audit process, operate according to the assumption that the whistle-blowing duty, backed by regulations, makes a valuable contribution to the corporate governance landscape. In this light the comments of Power (1994, p. 25) are still pertinent:

'Audit remains a 'shiny black box...on the surface of which the aspirations of new regulatory programs can be reflected and made possible' but where stakeholders still do not 'look beneath the surface of audit practice into the box'.

---

## 7.4: SUMMARY

---

Chapter 6 considered the role played by the RI provisions in legitimising the South African Auditing Profession. This chapter extends this argument by highlighting how the reporting duty may be reminiscent of Foucauldian power and control. In particular, the whistle-blowing requirements influence 'what it means to be an auditor' (E7), creating a sense of enhanced accountability and individual responsibility on the part engagement leaders. This magnifies the effects of fines and imprisonment for not complying with s45 of the APA, striking at the very essence of the professional identity of individual partners and the reputation of their respective firms. Consequently, disciplinary power reinforces perceived improvements to audit quality

control systems (Chapter 4; Chapter 5) and claims to legitimacy (Section 6.1) by virtue of normalising pressures that create a reasonable expectation of active whistle-blowing by auditors. Concurrently, disciplinary power is at work on the audited. Irregularities that would otherwise have gone unnoticed are indirectly made public due to the auditor's duty to bring these to the attention of the IRBA. Applications of technical audit procedures; the existence of independent reporting channels; and the possibility of inspection by either the IRBA or other regulator become reminiscent of the process of examination, surveillance and normalising sanction. This leads to the conclusion by some respondents that: 'there is definitely a policing flavour' (U9) to the APA which results in a view of the RI provisions as a corporate transparency and compliance enhancing mechanism.

There was, however, no guarantee that every auditor reported every RI, irrespective of the size of the firm<sup>122</sup>, a view confirmed by all respondents. Several reasons for this were offered. Firstly, users and experts agreed that ethical behaviour cannot be legislated, a sentiment shared by Agulhas (2007), McMillan (2004) and Low et al (2008). Hence, there is an inherent risk of rogue auditors disregarding the RI provisions due to the practical limitations of the IRBA to observe effectively each audit engagement and the ever-present issue of application of ethical and professional judgement. Secondly, as predicted by Roberts (1991; 2009) and Pesqueux (2005), self-preservation and the effect of underlying capitalistic pressures are not totally resolved by the legislation with the result that auditors, fearful of sanctions or losing a client, may adopt a legalistic attitude when it comes to dealing with RI's or simply disregard the duty to blow the whistle. This effect may be more pronounced for smaller audit firms or audit partners with a smaller portfolio of clients who, accordingly, lack the resources to mitigate these pressures. In this way, resistance to panopticism implies that s45 of the APA may have some effect on auditor reporting but that the effect is not as extensive as the panoptic metaphor implies.

A second limitation of the power and control model is that, *prima facie*, 'visibility' stands in contrast with audit deriving an important source of its legitimacy from its opacity or claims to almost 'mythical' expertise (Section 2.3). Decoupling and mimetic isomorphism address this tension. As explained by Meyer and Rowan (1977) by 'exalting ceremony and myth', the RI provisions retain much of the underlying cognitive legitimacy associated with disciplinary power even though the technicalities of audit practice cannot be perfectly reconciled with Foucault's (1977) model of power and control. The audit process cannot be directly observed (DeAngelo, 1981b); technologies for documenting and evaluating every judgement made by the auditor do

---

<sup>122</sup> See, however, the limitations described in Section 1.4.2.

not exist (IAASB, 2009f); and the IRBA is unable to know, in a practical sense, whether or not every RI has been reported. Nevertheless, almost all users continued to accept the surveillance *potential* of the whistle-blowing duty as a material contribution to the corporate governance landscape.

Together with the power of punishment itself to accentuate the legitimacy of the audit profession (Guénin-Paracini and Gendron, 2010), a motif of disciplinary force becomes an important part of accepting s45 of the APA as a natural and logical part of the emerging external regulatory paradigm. This is especially true for ‘outsiders’, not as a result of an expectation gap<sup>123</sup>, but because, despite elements of enhanced visibility, they remain unable to observe directly the audit process. Paradoxically, rather than serve as a stumbling block, this means that notions of visibility inherent in the disciplinary power framework are an inextricable element of the opacity of audit (Power, 1994; Power, 2003) allowing the RI provisions to afford legitimacy to the profession while, at a technical level, limitations to effective whistle-blowing remain. This confirms the thinking in Section 6.2: complex ceremonial processes are at work in regulating and legitimising the audit profession.

These findings are a result of the *first* critical evaluation of the role of the RI provisions in South African audit. They also build on the evidence presented in Chapter 4, Chapter 5 and Chapter 6. The findings are relatively complex and certainly not free of limitations. Consequently, Chapter 8 provides a summary of the main arguments raised in this thesis, highlights inherent shortcomings and identifies areas for future research.

---

<sup>123</sup> As discussed in Section 3.3, users are highly respected subject experts. These ‘inconsistencies’ cannot, therefore, be ascribed simply to misinformed expectations or a lack of understanding of the objectives of auditing.



## 8: CONCLUSION AND RECOMMENDATIONS

---

Chapter 8 provides an overview of the thesis. Section 8.1 summarises the findings, emphasising major themes identified by the detailed interviews (Chapter 4; Chapter 6; Chapter 7) and, to a lesser extent, the correspondence analysis (Chapter 5). Interconnections between the results chapters are also stressed, followed by a summary of the thesis's key contributions to the auditing literature (Section 8.2). Section 8.3 draws the reader's attention to the limitations of the study and identifies areas for future research. Section 8.4 concludes.

### 8.1: CONSOLIDATED FINDINGS

---

While we may know much about auditing in positivist terms, we know comparatively little about the attest function in the *real world* (Power, 2003; Carcello, 2005; Humphrey, 2008; Humphrey et al, 2011). This is especially true when it comes to recent regulatory developments, purportedly aimed at improving audit quality control systems and restoring a sense of confidence in the audit process. As a result, this research has followed the recommendations of Humphrey (2008, p. 179), dispensing with the 'reluctance to draw...on detailed contextual case studies' for the purpose of illuminating audit practice in a non-experimental setting. No effort was made to 'measure' audit quality. That has already been done (Francis, 2004). Instead, the research considers the South African context in which, in addition to the duty to express an opinion on a client's financial statements, auditors are required to report RI's to the IRBA, something which several interviewees described as an example of whistle-blowing. South Africa was chosen due to the fairly recent revisions to the reporting duties (Section 2.1) providing a current case for exploring a particular aspect of audit practice. It is also one of the few jurisdictions where auditors are faced with a broad, regulatory requirement to blow the whistle on clients, despite a duty of confidentiality (Nel, 2001; IRBA, 2006; Maroun and Gowar, 2013). By concentrating on South Africa, this research provides one of the first interpretive accounts of auditing (and, by default, corporate governance) from a non-Anglo-Saxon perspective<sup>124</sup> (see Brennan and Solomon, 2008; Maroun, 2012a). It simultaneously adds to the

---

<sup>124</sup> Per the Africa Leads Conference (2012), this thesis may well be the first example of critical auditing research from South Africa.

on-going debate on auditor reporting and quality (European Commission, 2010b; IAASB, 2012), concentrating on the continent's largest economy to explore the relevance of a complementary reporting duty as an example of a corporate governance mechanism.

This thesis commences with an investigation of the impact of s45 of the APA on perceived audit quality. Section 2.2 and Section 2.3 discuss how the prior research concludes that there is at least some merit in the call for a more arms-length regulation of the profession to improve audit quality (Bazerman and Moore, 2011; Lesage and Wechtler, 2012). South Africa's RI provisions are no exception, addressing a need for improved reporting by auditors along similar lines to the European Community (CESR, 2007; European Commission, 2010b) and IAASB (2012). In this context, Chapter 4 considers whether the reporting duty has had any perceived relevance for participation on audits by engagement leaders (Section 4.1); adherence to ethical principles including client acceptance and continuance decisions (Section 4.2); and human resources, engagement performance and monitoring (Section 4.3). Each of these 'quality metrics' was derived from ISQC 1 (Section 1.2; Section 2.2). This allowed the research to consider audit quality control systems (and, indirectly, audit quality) more holistically than studies following a positivist approach which focus on a limited number of quality surrogates. While there is a risk of falling victim to the profession's self-serving claims to technical expertise (Power, 2003), this is mitigated by the fact that ISQC 1 is subject to due process, is comparable to US GAAS, and echoes many of the principles found in the prior audit quality and corporate governance literature.

The first results chapter found that there has been little perceived impact on audit practice as a result of the RI provisions. Considering ISQC 1's emphasis on ethical business practice, including sound client acceptance and continuance protocols, most respondents reported that the RI provisions had only marginal relevance. For almost all experts, existing policies and procedures already accommodated the effect of the reporting duty. The same was true when it came to engagement performance and human resource practices. Respondents confirmed that the RI provisions had not altered the 'nuts and bolts' of audit by imposing additional requirements on auditors, other than to inform the IRBA, should the practitioner encounter an RI. More significant was a sense of professional duty, professional appearance, and conceptions of a personal duty to the respective firm, thereby confirming the findings of *inter alia* Carrington (2010), Wyatt (2004) and McMillan (2004). This is not to say that the RI provisions are irrelevant.

Most interviewees felt that the whistle-blowing duty led to enhanced reporting by auditors resolving a tension between owing a public duty to bring transgressions into the open and the need to ensure confidentiality of client information. Section s45 of the APA increases the likelihood of reporting transgressions by providing a formal reporting mechanism that clarifies when and how one ought to blow the whistle, as well as a basis for rationalising reporting to a client. Complementing this is the fact that it is an independent regulator, rather than the auditor, who decides whether or not an RI is brought to the attention of the relevant third parties, effectively adding additional 'layers of independence'. Finally, the requirement to bring any act of fraud, or other irregularities, without delay, to the attention of the IRBA mitigates the risk of professional judgement or client pressure leading to reduced whistle-blowing, even when reporting is ultimately in the public interest (Section 4.3; Chapter 5).

Going hand-in-hand with promoting effective whistle-blowing are claims of improved transparency and accountability and a resulting sense of enhanced auditor legitimacy. Section 6.1 argues that, by complementing the auditor's reporting duties, the RI provisions appeal to the interest of constituents providing material benefits to stakeholders and, thus, serving as a source of exchange legitimacy. Concurrently, with trends in corporate governance pointing to the importance of improved disclosure for stakeholders (IOD, 2009; IIRC, 2011; IRC, 2011), influential legitimacy may result. Complementing this is the perception of the whistle-blowing duty as 'the right thing to do' (U1), 'invaluable for the public interest' (U9; E9) and iterating the auditor's societal duty to serve as a 'watchdog' (U3; U10) which appeals to a sense of moral legitimacy. This is enhanced by the RI provisions being enshrined in statute, belief in their procedural rigour and an assumed practical ability for auditors to discharge the whistle-blowing duty. By then appealing to the every-day ideal of audit serving as a 'watchdog', reinforced by a taken-for-granted belief in pro-social whistle-blowing discourse, a sense of cognitive legitimacy results. Adding to this is the fact that the RI provisions form part of the move from a self-regulatory approach paradigm which, in the aftermath of numerous corporate scandals, may be suffering from an impaired legitimisation potential (Section 2.3). Requiring the auditor to report transgressions signals a move towards arms-length regulation to preserve trust in the audit process. More specifically, the RI provisions may be part of the response to regulatory development abroad. With South Africa's major trade partners and providers of capital appearing to favour external regulation (Manuel, 2002; Konar et al, 2003; Malsch and Gendron, 2011), s45 of the APA serves as an example of isomorphism aimed at ensuring legitimacy.

These results confirm the findings of Power (2003) - that audit is a social construct and that, paradoxically, it is able to confer legitimacy on organisations, yet depends heavily on legitimacy in its own right in order to do so. External regulation is not only about improving audit quality, as much of the prior literature suggests. By appealing to notions of pragmatic, moral and cognitive legitimacy, it is an important means of securing belief in auditors' 'rituals' of verification (Pentland, 2000), something particularly important given that the only 'element' of audit capable of direct observation is a single sheet of paper expressing an opinion on financial statements.

Under the lens of institutionalism, more critical perspectives are also possible. Suchman (1995, p. 579) warns that 'organisations often put forth self-serving claims of moral propriety and buttress these claims with hollow symbolic gestures'. Similarly, Power (1994) and Unerman and O'Dwyer (2004) argue that seldom are regulatory developments untainted by various agendas. As discussed in Section 2.3, governments, having a vested interest in the functioning of capital markets, and, thus, audit, may use external regulation as a means to legitimise the assurance function superficially. With this in mind, Section 6.2 elaborates on how the RI provisions play an important perception management role. With an aim to demonstrating how South Africa is not lagging behind in the race for more external control over the profession post Enron et al, s45 of the APA may have been hastily enacted. It serves as an example of how Government, not having the 'resources or the know-how' to tackle problems facing the audit profession (for further commentary see McMillan, 2004; Wyatt, 2004; Pesqueux, 2005), 'is now creating this legislation to make things look good from the outside' (U4). Despite the additional reporting duty, audit remains the 'black box' described by Power (1994). Additional external regulation is simply creating the impression of audit being 'immunised' against subsequent failure. The move towards more arms-length regulation to echo developments abroad forms part of this 'ceremonial display'. The debate on audit quality - and the role of new laws and regulations in improving it - is far from resolved (for examples, see McMillan, 2004; Vakkur et al, 2010; Bronson et al, 2011; Deng et al, 2012; Ianniello, 2012). There is no guarantee that external regulation, like SOX, will necessarily materially add to audit practice and quality and prevent future audit failures. What is, however, key is an assumption that the audit profession's self-regulatory franchise is no longer adequate to safeguard the interests of stakeholders and that external regulation is a powerful alternate source of legitimacy (Section 2.3). In this way, legislation that introduces material change may not be the primary purpose for the RI provisions. Also 'important is making our otherwise inefficient Government look like it's getting up off its arse when the you know what looks like it's starting to hit the fan' (U10).

Can these views be reconciled with those in Section 6.1? Further, how can Chapter 4 conclude that the RI provisions do not substantially impact on every aspect of audit practice but yet still serve as an important source of pragmatic, moral and cognitive legitimacy for the audit profession? Section 6.2, inspired by the work of Meyer and Rowan (1977), DiMaggio and Powell (1983) and Suchman (1995), explains how complex processes of decoupling are used to cleverly interconnect disjointed or ‘conflicting’ institutional ‘myths’.

In line with the findings of Humphrey (1990; 2012), perceptions of legitimacy arise from the image of external regulation making an important difference, something which is effectively decoupled from technical or operational contradictions. The formality of the reporting duty, the existence of an independent regulator, sanctions for non-compliance and taken-for-granted belief in the technicalities of audit are powerful images that reinforce claims to cognitive legitimacy. This is bolstered by the fact that, at least in theory, the auditor is capable of discharging his ‘pro-social’ reporting duty. The increase in the number of reports issued to the IRBA when RI’s replaced MI’s (Section 2.1), as well as the *theoretical* contribution that several respondents felt the legislation offers, ‘prove’ that the RI provisions are working. The same may be said of the fact that South Africa is ranked first globally for the quality of its accounting and auditing standards (see IRBA, 2010b; IRBA, 2012c). That the RI provisions’ ‘contribution’ cannot be quantified, the audit processes remains opaque, the reporting duty is possibly vague and inconsistently applied and that the precise manner in which the IRBA deals with RI’s is not fully understood by stakeholders is largely overlooked. What matters is not the actual outputs, but ‘simply that the legislation *exists*’ (E2, emphasis added). In other words, ‘outputs, procedures and structures...can all signal that the [institution is legitimate]...even if these supposed indicators amount to little more than face work’ (Suchman, 1995, p. 588).

The RI provisions make some contribution to actual audit quality and are a possible source of legitimacy (Chapter 4; Chapter 5; Section 6.1). Under the lens of institutionalism, however, the whistle-blowing duty also has a marketing role to play. By creating a reporting duty which appears broad and grounded in the desire to bring RI’s into the public domain, the RI provisions are assumed to be rationally effective. Good faith emanating, ironically, from the ambiguity inherent in the application of the RI provisions and the absence of clearly defined outcomes takes hold. The RI provisions are seen as part of an audit-reporting-quality discourse that reassures stakeholders of the credibility of the attest function and enhances its claims to legitimacy. Simultaneously, continued opacity of the audit process ensures the obfuscation of

inconsistencies between the technicalities of the APA and perceptions of constituents (see Meyer and Rowan, 1977; Fogarty et al, 1991; Suchman, 1995); 'absorption of uncertainty'; and a 'contribution to a general aura of confidence' (Meyer and Rowan, 1977, p. 358). Rather than see an apparent 'tension' between the findings in Chapter 4, Chapter 5 and Section 6.1, on the one hand, and Section 6.2, on the other hand, what the results confirm is that audit is part of complex socially constructed milieu and that, more broadly, 'institutional environments are often pluralistic' with 'societies promulgat[ing] sharply inconsistent myths' (Meyer and Rowan, 1977, p. 356).

In keeping with a more interpretive/critical style, the final results chapter considers the relevance of Foucauldian power and control. One of the shortcomings of positivist research is the focus on economic rationality to the detriment of powerful, yet difficult to explicate, socio-political forces (Section 2.2; Section 2.4). Section 7.1 argues that, far from a technical economic instrument, the reporting duty is an example of technologies of surveillance, discipline and punishment. Specifically: the rigid approach to reporting; prescriptions on what irregularities are 'reportable'; and holding individuals accountable for failure to report are reminiscent of principles of enclosure, efficiency and surveillance. This is complemented by the general theme of whistle-blowing as a means of improving corporate transparency and accountability. At the extreme, a 'disciplining gaze' is cast on at least some users who note that the RI provisions give rise to a sense of being 'watched', something which has the potential to work on the minds of certain of the audit clients. This reaffirms views of s45 of the APA making a positive contribution to audit practice, as argued in Section 4.3. For some interviewees it imposes a meaningful reporting duty in addition to the professional obligation to express an opinion on a client's financial statements, bolstering existing corporate governance systems (consider Opperman, 2009; Roberts, 2009; Humphrey, 2012).

Disciplinary power may also function on audit firms. Experts reported that the whistle-blowing duty 'focused the mind', offering a window into the conduct of the individual partner by the IRBA, internal reviewers and peers. The risk of sanctions, as well as the 'disgrace' of being labelled non-conformist, works on the very soul of some audit partners ensuring the reporting duty is complied with. In turn, this perspective provides an explanation for why exogenous control over the audit profession gains favour over a self-regulatory ethos. As a source of disciplinary power, the RI provisions become akin to a process of normative examination leading to a sense of surveillance and 'normalised' behaviour. Section 45 of the APA, therefore, contributes, not only

to increasing the information made available to stakeholders, but also in creating a valid expectation of active monitoring and reporting by auditors which is ultimately in the public interest.

The utility of disciplinary power may also lie in its ability to confer a sense of legitimacy. This is alluded to by Leon's (2001, pp 3-4, cited in Brivot and Gendron, 2011) statement that:

‘Surveillance always carries with it some plausible justification that makes most of us content to comply...The advantages of surveillance for its subjects are real, palpable, and undeniable. We readily accept the point of it’.

Section 7.2 drew a link between constructs of Foucauldian power and control and claims to pragmatic, moral and cognitive legitimacy. When one considers that modern society is characterised by subtle displays of disciplinary power (Foucault, 1977; Smart, 2002; Roberts et al, 2006; Brivot and Gendron, 2011), fines, penalties and professional sanctions for non-compliance with the APA reinforce a sense of cognitive legitimacy inherent in the RI provisions. Almost all respondents conclude that ‘if you are doing something wrong, it’s got to be reported’ (U10) and that for the legislation to play a credible role, it must have ‘all the right “ingredients”: a legal duty..., an independent regulator and...some teeth’ (U14). Discipline, punishment and external regulation are, therefore, interconnected with an assumed or taken-for-granted confidence in the reporting process. Traces of disciplinary power appeal to claims to pragmatic and moral legitimacy by fostering a ‘good faith’ belief in formal, rational processes and reassuring users that favourable reporting by auditors occurs, as was argued in Section 6.1.

Motifs of disciplinary power may, however, be illusory. Specifically, the limitations of the ‘panoptic gaze’ and the possibility of Foucauldian power being interconnected with ceremonial displays of legitimacy and control should not be overlooked. Section 7.2 explores resistance to panopticism that leads to either a legalistic attitude towards the RI provisions or self-preservation. Contrary to the predicted effects of disciplinary power, the role of the auditor is not universally altered. A sense of commitment to serving the public interest by reporting irregularities is not reinforced for *all* auditors. As an ultimate act of resistance, s45 of the APA may simply be circumvented, a plausible response given the practical difficulties of rendering the audit process more transparent, coupled with auditors’ fear that whistle-blowing could lead to the loss of the client. From this perspective, the RI provisions’ contribution to reassuring

stakeholders of the quality and credibility of the audit process may be more symbolic than pragmatic.

A similar outcome results when one considers the tension between auditor legitimacy derived from its opacity (Humphrey and Moizer, 1990; Power, 1994; Power, 2003; Humphrey, 2008; Humphrey, 2012) and the potential for enhanced transparency per Foucauldian theories of power and control. At first glance, these theoretical perspectives seem mutually exclusive. Section 7.3 further adapts Meyer and Rowan's (1977) model of decoupling to reconcile these apparent conflicting views and to reinforce the complex interconnections between auditor regulation, legitimacy and Foucauldian power and control. The section argues that motifs of discipline and punishment are integral to belief in external regulation being an effective response when the audit profession is beset by a crisis of trust. In particular, the whistle-blowing duty meshes with the conviction that trust itself is no longer sufficient necessitating the use of additional technologies of surveillance to heighten a sense of transparency and accountability (Power, 1994; Pentland, 2000; Roberts, 2009). This, together with the inherent limitations of panoptic-like control, implies that it may be the mere *appearance* of a *plausible* monitoring apparatus that is sufficient to win the confidence of stakeholders and confer a sense of credibility for the attest function. As was argued in Section 6.2, any tensions between a facade of panoptic control, resistance to additional surveillance, the practical impossibility of achieving total enclosure and difficulties encountered when attempting to 'normalise behaviour' are effectively decoupled from the belief that the RI provisions are able to render processes more 'visible'.

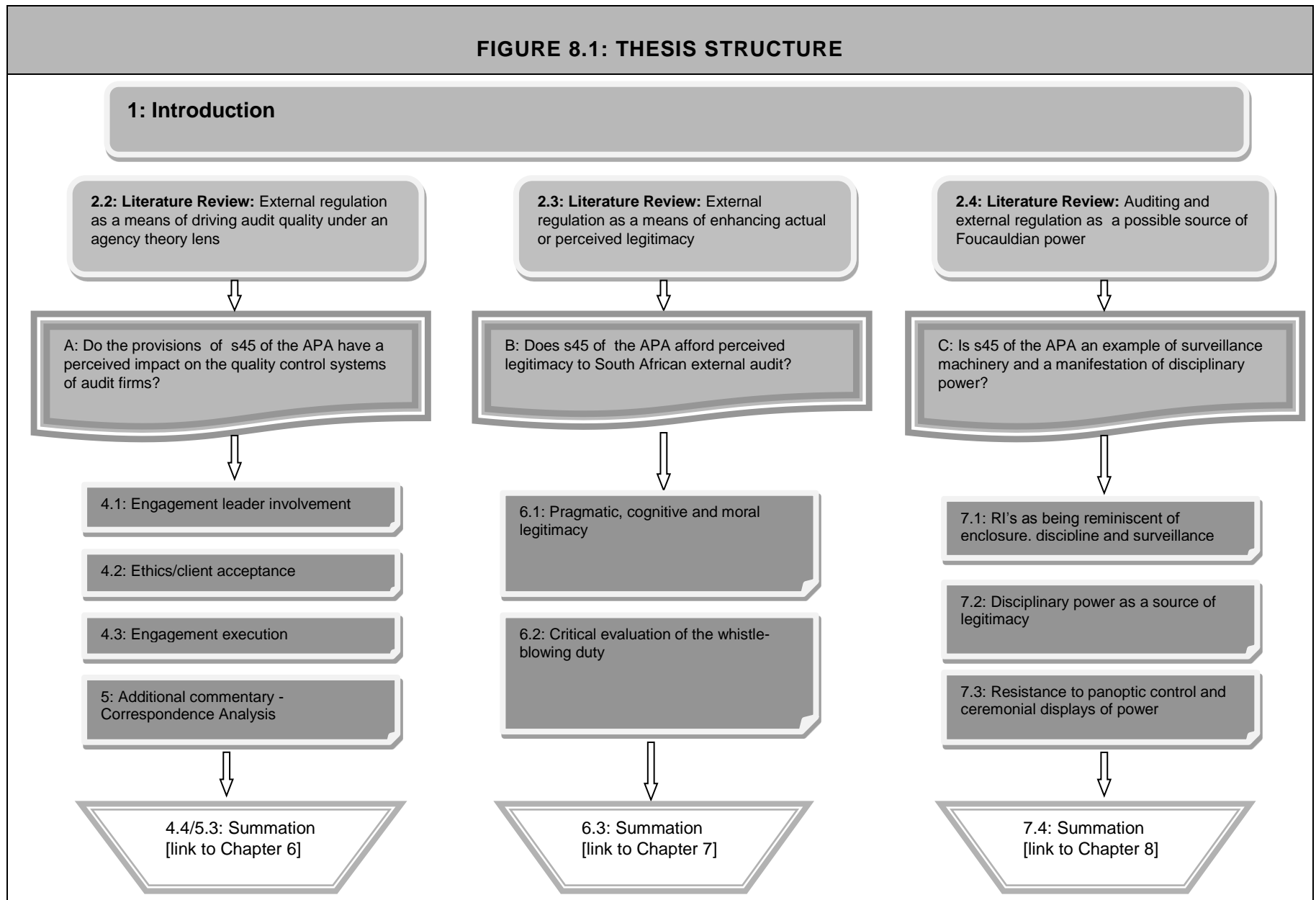
For several interviewees, the whistle-blowing duty backed by inspections, independent regulators and the force of law is a genuine part of the regulatory environment and a source of legitimacy for the audit profession. This is further 'rationalised' by the growing use of external regulation backed by sanctions for noncompliance; a desire for improved transparency; and 'natural' acceptance of motifs of power and control as a means of encouraging desired behaviour. The 'ceremonial myth' – in this case the general belief in auditor regulation as an example of a disciplinary power in action – is exalted while practically, little change to audit practice results. Inconsistencies and practical difficulties that undermine the effectiveness of the RI provisions are 'buffered' from the 'assumption that formal structures are really working' (Meyer and Rowan, 1977, p. 357).



On the one hand, this means that the RI provisions are not able to totally alter audit or its reporting duties. On the other hand, the RI provisions contribute a 'control' and 'remediation discourse'. This appeals implicitly, almost subconsciously, to a need for enclosure or restriction of both corporates and auditors in the aftermath of publicised failures, cultivating confidence or 'trust' in the underlying capital systems. A paradox results in that 'trust' becomes a product of additional regulation, the former only emerging because trust itself is no longer sufficient. What makes motifs of Foucauldian power particularly pertinent is their subtlety. Subtle displays of power are easily decoupled from the tension between external regulation and notions of trust which, if made more explicit, might highlight the flaws of expert systems culminating in a total loss of confidence.

Contemporaneously, the *appearance* of enclosure, examination and surveillance re-establishes any lost legitimacy. As theorised by Guénin-Paracini and Gendron (2010), motifs of Foucauldian power and control, even if lacking actual effects, are often sufficient subtly to restore a sense of order. Given the taken-for-granted belief in the utility of discipline and punishment, technical stumbling blocks are easily overlooked. Ultimately, this suggests that Foucauldian power and control and mechanisms of legitimization come to 'partake of the same process of mythification' (Guénin-Paracini and Gendron, 2010, p. 155).

**FIGURE 8.1: THESIS STRUCTURE**



## 8.2: SUMMARY OF KEY CONTRIBUTIONS

---

This thesis has made a number of important contributions. As noted above, it is one of the first detailed accounts of auditing in a non-Anglo-Saxon setting, addressing the need for additional corporate governance research from an African perspective (Brennan and Solomon, 2008). At the same time, the findings are grounded in an interpretive epistemology. This has allowed the research to escape the confines of agency-theory and its assumption of rational utility maximisation and economic efficiency as the driving force behind regulatory developments. By relying on detailed interviews with audit experts and informed users, the research has illuminated the operation and perceived implications of a particular aspect of audit practice, addressing the calls for more field-work inspired studies in auditing (Power, 2003; Humphrey, 2008). Interconnected with this is the use of ISQC 1 for describing audit quality control systems. Rather than focus on one or two assumed quality surrogates (Francis, 2004), multiple dimensions of audit quality/quality control systems are examined, allowing the research to contribute to the general understanding of audit quality, as well as highlighting how issues concerning audit quality control systems are dealt with in a practical setting.

Second, the thesis provides *the first* exploratory account of South Africa's RI provisions. Although there are numerous technical papers on the subject (examples include Dunn et al, 1989; IRBA, 2006; PwC, 2006) there has been no concerted effort to provide a detailed conceptual account of the role played by the RI provisions in South African audit. In doing so, this thesis has also highlighted a strong connection between a particular aspect of external audit, a reporting duty as an example of whistle-blowing and legitimacy theory. For example, and as discussed in Section 1.2, there is a considerable body of work dealing with the definition of whistle-blowing (Miceli and Near, 1984; Jubb, 1999); decision-making processes involved in the act (Leeds, 1963; Nam and Lemak, 2007; Reckers-Sauciuc and Lowe, 2010); and implications for the whistle-blower (Hwang et al, 2008; Reckers-Sauciuc and Lowe, 2010). The prior research, however, deals almost exclusively with reporting of transgressions in a traditional employer-employee context and largely ignores assurance functions<sup>125</sup>.

Likewise, there is a well-established body of work that examines audit from an institutional perspective (Humphrey and Moizer, 1990; Sikka et al, 1998; Power, 2003). As discussed in

---

<sup>125</sup> An exception is Read and Rama (2003) who deal with whistle-blowing to and reporting of illegalities by internal auditors and Brennan (2007) who looks at whistle-blowing by trainee auditors.

Chapter 2, this research points to the social construction of audit practice. For example, and dealing specifically with the issue of auditor reporting, Unerman and O'Dwyer (2004) present the audit report as an example of a 'token symbol' embodying a cognitive belief in the role of audit, similar to the views of Power (1994; 2003) and Pentland (1993; 2000). Several authors have also explored how an assumed fraud detection duty forms part of an expectation gap that, ironically, contributes to the standing of the profession by allowing audit to remain opaque or 'mystical' in the eyes of non-expert users while also preserving its image and claims to perceived utility (Fogarty et al, 1991; Humphrey et al, 1992; Sikka et al, 1998). How a specific duty to bring transgressions to the attention of an independent regulator with an aim to broadening what auditors actually report is not, however, considered. This is especially pertinent given the recent calls for auditors to do more than just provide a generic audit report on a client's financial statements (CESR, 2007; European Commission, 2010b; IAASB, 2012). In this regard, the research provides a novel assessment of the role of audit reporting duties, not only in the context of audit quality, but as a means of enhancing the perceived legitimacy of external audit. The research, thus, expands on the existing body of institutionally-focused audit research, simultaneously making a connection between whistle-blowing and conceptions of both audit quality and auditor legitimacy.

Thirdly, much of the existing interpretative or critical research is discursive. The efforts of Fogarty (1991; 1992), Power (1994; 2003) and Sikka et al (1998), for example, make important contributions but identify, as an area for additional research, the need for contextual studies to illuminate the operation of complex socio-institutional phenomena (Humphrey, 2008). In providing a detailed account of the RI provisions under the lens of legitimacy theory, this thesis goes some way to addressing this need. In addition, the research does not refrain from including a more critical bite. How the RI provisions may form part of a complex ceremonial display is explicated, as well as processes of decoupling, providing a *quasi* case study that illustrates the assertions of the above researchers and *inter alia*, Meyer and Rowan (1977), Suchman (1995) and DiMaggio and Powell (1983).

Continuing in the spirit of more critical interpretation of audit regulation, the research explores the connections between the RI provisions and motifs of disciplinary power. Accounting research couched in a Foucauldian theoretic construct is fairly common (Section 2.4). Few

papers have, however, adopted this perspective in an auditing context<sup>126</sup>. The thesis provides one of the first accounts of principles of enclosure, efficiency and disciplinary power at work in a corporate governance setting (Section 7) adding to our understanding of the audit reporting. It also elaborates on the relevance of resistance to Foucauldian power and control, showing how legalistic mindsets and the drive for self-preservation may dilute the intended benefits of s45 of the APA (see also Sikka, 2009; Tremblay and Gendron, 2011).

Not only does this expand on the application of Foucauldian theories of power and control, it also allows the research to make a tentative connection between discipline and punishment and claims to legitimacy. Specifically, Chapter 7 has dealt with how hues of normalising sanction, examination and surveillance contribute to claims of enhanced audit quality and standing. The 'natural' acceptance of disciplinary power in modern society is also highlighted, offering an explanation for why more external control of the profession may be favoured in the aftermath of corporate scandals. The plurality of audit regulation is then expanded on, with the thesis considering how motifs of disciplinary power may contribute to a complex ceremonial display reminiscent of Meyer and Rowan (1977) and Suchman's (1995) account of institutionalised environments.

Overall, this research provides a detailed exploratory account of South Africa's RI provisions. Mindful of the need for theoretical eclecticism (Llewelyn, 1996; Llewelyn, 2003), the prevalence of agency theory (Brennan and Solomon, 2008) and social-construct of auditing (Khalifa et al, 2007; Humphrey, 2008), the research examines the RI provisions as an example of external regulation attempting to enhance audit reporting and quality, accord legitimacy and entrench a sense of added control and transparency. In doing so, it contributes to the exploration of audit practice, providing a conceptual account for external regulation in a South African context with many of the underlying principles identified applicable for future research in different jurisdictions.

---

<sup>126</sup> Per discussion at the Africa Leads Conference (2012), this thesis is the first to do so in a South African setting.

This thesis is not without limitations. More needs to be done on exploring how the reporting duty interconnects with other regulatory developments taking place both locally and abroad, especially given the increasing globalisation of professional audit firms and institutionalisation of external regulatory movements in foreign jurisdictions (Humphrey et al, 2009; Malsch and Gendron, 2011; Tremblay and Gendron, 2011). While this thesis has shed light on a specific example of an auditor reporting duty, examining other regulations in different jurisdictions will further our understanding of how arms-length control of the profession is responded to and implemented by audit firms. In turn, this will require dedicated research on the culture of governance at the leading audit firms themselves (Sikka, 2004).

Audit firms are profit-orientated entities. They strive for engagement efficiencies, lower costs and larger client bases and have a clear economic interest in regulatory developments (Sikka and Willmott, 1995; Sikka, 2009; Windsor and Warming-Rasmussen, 2009). To better understand the role of the RI provisions (and arms-length regulation in general), future research needs to consider the tactics that may be employed by audit firms to balance adherence to the law with the need to ensure sound client relations and profitability (Mitchell and Sikka, 2002; Sikka, 2009; Tremblay and Gendron, 2011). This balancing act is most relevant in light of the dissonance between concerns about a growing propensity of auditors and clients to resist technologies of accountability and transparency (Sikka, 2009) and the proliferation of external regulation, in response to new crises of trust, aimed at precisely that (Malsch and Gendron, 2011; Maroun et al, 2012). Consequently, while there is a vast body of positivist work testing audit quality surrogates (Section 2.2.2) what is needed is more exploratory research that delves into the nature and corporate ethos of audit firms, as well as the social and organisational context in which audit engagements are executed. This thesis has only partially addressed this<sup>128</sup>. It highlights how s45 of the APA plays a role in mitigating client pressures that would otherwise have hindered the reporting of irregularities but that the whistle-blowing duty cannot completely address the risk that auditors – driven by the desire to preserve the client relationship – may not always comply with the RI provisions (Section 7.3.1). Consequently,

---

<sup>127</sup> This section of the thesis should be read in light of the limitations and delimitations identified in Section 1.4.2.

<sup>128</sup> The aim of the thesis was to explore the role of the RI provisions in South African audits (Section 1.4) and not to deal specifically with threats to the fundamental principles and how these may be resolved.

future research will need to concentrate specifically on threats to compliance with the fundamental principles and on developing innovative (albeit normative) recommendations for tackling impediments to audit quality, such as economic dependence on clients and capitalistic business models at most audit firms (McMillan, 2004; Pesqueux, 2005; Sikka et al, 2009). This is especially true as the values of the audit firms will likely 'guide all work within [these] firms, shape the conflicts of interests faced by auditors and facilitate audit failures' despite efforts at more actively regulating the profession (Sikka, 2004, p. 195).

Going hand-in-hand with this, is the need for theoretical and methodological eclecticism. For example, it would be interesting to explore how past events have impacted on regulatory change in South Africa, something which has only been touched on in this thesis. Additional insights could be gained by replacing 'historical facts' in a 'known timeline' with 'counterfactuals in order to compare alternative and recorded outcomes' (Lee, 2006, p. 919). Posing a series of 'what if' questions concerning the development of the RI provisions could, for instance, reveal the relevance of South Africa's transition from Apartheid to democracy or the release of the King reports for whistle-blowing by auditors. Analogously, Giddens's (1990; 1991) mechanisms of modernity predict that changes to auditor regulation are part of the process of 'internalising' developments taking place abroad and locally with an aim to preserving trust in the South African capital market. Rather than see the RI provisions in isolation, the change from MI's to RI's may be part of a broader change in South Africa following its transition to democracy, including subsequent political, economic and social challenges. This implies that the RI provisions could be an inextricable part of the country's social, economic and political past, as well as a product of developments taking place in various jurisdictions at different points in time. Reforms in other developing economies may follow a similar trend, re-emphasising the need for active corporate governance research in multiple countries to test existing theories and expand our understanding of how governance mechanisms evolve and function in different settings (Brennan and Solomon, 2008).

Part of this could include explicitly studying the relationship between trust, regulation and 'technologies' of accountability. Claiming that arms-length regulation restores trust or confidence in the capital market system (Tremblay and Gendron, 2011) highlights a contradiction in that external regulation is only required because trust itself is no longer adequate (Black, 2008). In examining the role of the RI provisions (and other auditor-focused reforms) more needs to be done to understand the extent to which external regulation is able to substitute for trust and the

characteristics of arms-length regulation that allows it to do so. This thesis has tentatively pointed to motifs of disciplinary power and claims to legitimacy as possible traits. Future research could complement this by using Luke's model on power dynamics to explore how relationships between governments, regulators and auditors shape regulatory developments and reassure stakeholders in the continued credibility of the attest function (see also Sikka et al, 1998; Malsch and Gendron, 2009; Tremblay and Gendron, 2011). Likewise, how whistle-blowing and external regulation shape the discourse on audit reporting and corporate governance in general could add to our understanding of external regulation as an instrument of legitimisation (Khalifa et al, 2007).

In order to highlight different views on mechanisms of accountability, considering the opinions of multiple stakeholders is also important (Brennan and Solomon, 2008). Purposeful selection of respondents (Section 3.3) has ensured accurate, relevant and detailed commentary that adds to the quality of the findings. Reliance on a relatively small group of specific subject experts is, however, an inherent limitation of qualitative studies (Holland, 2005; Rowley, 2012)<sup>129</sup>. In particular, this meant that the role played by the RI provisions in either contributing to or reducing the 'expectation gap' could not be fully explored<sup>130</sup>. Consequently, the results chapters did not provide conclusive evidence on different perceptions of the RI provisions by users, on the one hand, and experts on the other. One of the only exceptions was Section 7.2.3 where, contrary to the opinions of experts, most users felt more strongly about the positive effects of s45 of the APA's associated disciplinary mechanisms. The divergence in views was, however, better attributable to the fact that users were not privy to detailed processes followed by the audit firms and the IRBA when dealing with the RI's. With interviewees including some of the leading minds in the audit and corporate governance in South Africa, making a case for the presence of an 'expectation gap' was not appropriate. Future research may, therefore, make a contribution to the audit literature by examining the 'elements' of the audit expectation gap in South Africa and whether or not the RI provisions form part of a divergence in the understanding of the purpose and scope of external audit. In addition, exploring varied meanings of audit and perceptions of the RI provisions could highlight how competing worldviews, institutional structures, socio-political power and generally accepted 'truths' about the attest function

---

<sup>129</sup> In addition, the risk of interviewees withholding details or being misinformed cannot be totally mitigated (Oakes et al, 1998; Alvesson, 2003; Creswell, 2009) although the detailed and frequently critical commentary provided in preceding chapters implies that this was not a significant threat to the quality of this research.

<sup>130</sup> Audit expectation gap research, by its nature, requires the consideration of numerous classes of user groups and multiple participants to reach an informed conclusion on the nature and extent of any divergence of expectations (Humphrey et al, 1993a; Gold et al, 2012; Porter, 2012).



'construct' multiple (and possibly conflicting) roles for whistle-blowing by external auditors (see Sikka et al, 1998; Khalifa et al, 2007). Alternately, Hwang et al (2008) point to the possibility of numerous social or cultural variables influencing perceptions of whistle-blowing, including variations in fear of retaliation (Miceli and Near, 1984; Nam and Lemak, 2007; Seifert et al, 2010). Each of these may impact views on the role of the RI provisions. Given the country's diverse cultures, this may be particularly relevant. For example, West (2006, p. 445) explains how the Anglo-American model of corporate governance, which inspired the King Codes, 'stands in contrast to the normative prescriptions from African intellectuals who espouse communitarian values including communal rights [and] consensual decision-making'. The same may apply *mutatis mutandis* to views on the RI provisions as a means of improving audit reporting or as an instrument of legitimacy or disciplinary power.

Analogously, no effort was made to deal specifically with how large and small audit firms interpret the RI provisions<sup>131</sup>. Considering how opinions on the reporting duty vary between representatives from the Big 4 or smaller practices would contribute to the existing body of audit quality research based on a quality-size distinction. Concurrently, future research could focus on how varying organisational cultures and operating dynamics at large and small firms impact the assessment of the RI provisions and notions of audit quality, legitimacy and disciplinary power. This could be complemented by studying how age, experience or cultural background impacts the perceived role of the RI provisions by auditors (see also Fogarty, 1992; Schultz et al, 1993; Brennan and Kelly, 2007).

Another aspect not specifically covered by the research is the definition of 'audit quality'. ISQC 1 is used to inform the commentary on the association between the RI provisions and audit quality control systems. While some effort has been made to show parallels between the ISQC 1 and the prior literature on audit quality, research inspired by a grounded approach could identify additional 'elements' of audit quality not explicitly dealt with by either the academic or professional literature and complement the views detailed in this thesis<sup>132</sup>. Related to this, the relevance of auditor litigation has not been dealt with in detail. Several writers have argued that

---

<sup>131</sup> One of the only instances where the size distinction was raised by interviews was when explaining how smaller firms may lack the economic resources to withstand client pressures.

<sup>132</sup> This line of research would also add to the body of work on the relationship between various quality surrogates and elements of audit quality which, although extensive, is often carried out in developed economies. Further, Liao et al (2013) argue that determinants of audit quality may vary between high and low litigation risk environments. South Africa could provide a fruitful ground for expanding this line of research given the relatively inert civil-liability environment.

litigation risk is a relevant determinant of audit quality (Palmrose, 1988; Liao et al, 2013; Schmidt, 2012). The possibility of s45 of the APA giving rise to a risk of civil action against auditors has, however, only been touched on. Future research may concentrate on this aspect of the RI provisions to further our understanding of whistle-blowing in an auditing setting. For example, considering the need to afford auditors greater legal protection for *bona fide* discharging their reporting duty, and how this could mitigate or compound the problems of self-preservation (Section 7.3.1) or interact with motifs of legitimacy and disciplinary power (Section 7.2; Chapter 6) could prove interesting. This is especially true given the need to strike a balance between offering legal protection for auditors against civil claims to improve audit quality while avoiding offering legislated protection for substandard audit practice (Cousins et al, 1999; Sikka et al, 2009; Liao et al, 2013; Maroun and Gower, 2013).

Finally, the reader's attention is drawn to the cross sectional nature of this study. Research findings may vary over the long-run. How historical accounts of audit regulation and quality differ from modern perspectives is not directly addressed by this thesis. The result is that while this study has provided a detailed study on the role of the RI provisions in South African audits, it by no means offers a complete account.

---

#### 8.4: CLOSING REMARKS<sup>133</sup>

---

South Africa's RI provisions play an important part in the auditor-regulatory machinery. By creating a duty for auditors to blow the whistle on the client, s45 of the APA contributes to the quality of information made available to stakeholders. Related to this, the reporting requirement has a role to play in enhancing corporate compliance with laws and regulations, improving corporate transparency and accountability in the process. There is also evidence to suggest that it has relevance for audit quality, most notably independence. Related to this, is the ability of the legislation to confer a sense of moral, pragmatic and cognitive legitimacy on the profession, particularly, by enhancing the image of the auditor as a 'watchdog' that is 'meant' to serve the public interest. Interconnected with this is the move towards more exogenous control of the global audit profession, especially after numerous scandals have led to the rigour of the self-

---

<sup>133</sup> This thesis is carbon neutral. A total of twenty five tree seedlings have been planted to offset carbon emissions.

regulatory franchise being questioned. Finally, for some respondents, motifs of disciplinary power are present, reinforcing a sense of the RI provisions being an effective mechanism for improving corporate governance standards.

The legislation is, however, far from perfect. For these benefits to be enhanced, more active disclosure by the IRBA is needed. In carrying out this research, several respondents highlighted the need for greater transparency. While some statistics on RI's are available, more detailed information on the number of issues reported; pertinent details; and how these issues are being addressed could add to the credibility of the reporting process and accentuate claims to legitimacy and improved reporting quality. Related to this, the sanctions embodied in the APA – and associated threats to professional standing – play a role in 'working on the minds' of at least some users and experts. Motifs of discipline and punishment can create a valid expectation of auditors discharging their reporting duties. By more actively informing the market place of this reporting duty, these gains may be magnified. This would simultaneously make the reporting duty part of the governance parlance of even non-expert users and signal to both auditors and auditees that the RI provisions are regarded as an important aspect of the professional assurance function.

Presently, there is a risk that the RI provisions are perceived by some stakeholders as merely part of a symbolic display designed to reassure constituents of the soundness of the audit function and regulatory machinery. While these 'displays' are successfully decoupled from the technicalities of the reporting duty and, accordingly, still add to the standing of the profession, 'we need more than just imagery' (U3). As explained by Suchman (1995), superficial claims to credibility lack longevity. They fail to build on the audit profession's existing 'legitimacy reserve' in the long-run. One recommendation is for ambiguities inherent in the reporting duty to be resolved to ensure consistent application of the whistle-blowing obligation and avoidance of its circumvention due to legalistic behaviour. Complementing this is the possible need for direct legal protection for the whistle-blower to mitigate threat of legal action or risk of losing the client overriding the duty to report to the IRBA. While care would need to be taken to avoid sheltering poorly executed audits from legal action (Cousins et al, 1998) where the auditor, *acting in good faith*, blows the whistle, a clear, and practically relevant, defence against legal action from clients and third parties needs to be carefully considered (see also Maroun and Gowar, 2013). Finally, if sanctions for non-conformance are to continue being seen as effective safeguards against economic pressures working against reporting, reviews by the IRBA need to be more rigorous. They need to concentrate on whether or not the audit firms have *internalised* the spirit

of the legislation rather than just having checked the relevant boxes to demonstrate compliance. Going hand-in-hand with this is a clear need to tackle the pressures on audit firms themselves. The RI provisions go some way to achieving this by creating a mechanism for reporting, backed by a legal duty that offers auditors an 'escape hatch' or 'buffer' to justify reporting when in the public interest to do so. What the APA does not do is directly address underlying capitalistic pressures, including the mentality of serving the client rather than the stakeholder. A concerted effort is needed by both practitioners and academics to explore how these problems can be addressed. Rules for the rotation of audit partners or prohibition on non-audit services may not be a comprehensive solution. New and creative means of tackling an erosion of professionalism is needed, including enhanced training that leaves the image of the auditor as a 'watchdog' that 'is meant to serve the public interest' present in the minds of auditors.

## II: APPENDICES

---

The following appendices accompany, but are not part of, the thesis. Appendix A provides additional information on s45 of the APA. Appendix B contains results from the pilot studies. Appendix C complements the discussion on the derivation of the correspondence plot in Chapter 3 and Chapter 5. Appendix D and Appendix E contain the ethical clearance and template consent form respectively. Appendix F is a list of interviewees and Appendix G lists conferences where sections of this thesis have been prevented.

### APPENDIX A: SECTION 45 OF THE APA

---

#### A1: DEFINITION OF A 'REPORTABLE IRREGULARITY' AND RELATED TERMS

---

Section 1 of the APA defines a 'reportable irregularity as 'any unlawful act or omission committed by any person responsible for the management of an entity' (s1 of the APA, 2005). This 'unlawful act or omission' must be one which:

- a) 'has caused or is likely to cause material financial loss to the entity or to any partner, member, shareholder, creditor or investor of the entity in respect of his, her or its dealings with that entity; or
- b) is fraudulent or amounts to theft; or
- c) represents a material breach of any fiduciary duty owed by such person to the entity or any partner, member, shareholder, creditor or investor of the entity under any law' (s1 of the APA).

The APA does not define 'an unlawful act or omission' or 'person responsible for management of an entity'. While it is not the intention of this research to examine the technical structure of s45 of the APA in detail, a brief discussion of the elements of the definition of a reportable irregularity is provided to establish a context for this study.

### **'Unlawful act or omission'**

In *Reportable Irregularities: a Guide for Registered Auditors*, the IRBA (2006, p. 5) suggests that an 'unlawful act' would be some act, whether due to intent or negligence, which is effectively contrary to statutory or Common Law. 'Unlawful acts' may therefore include a breach of laws in various jurisdictions in which an entity operates if it can be shown that the person responsible for management of that entity ought reasonably to have known that that act or omission was effectively unlawful (IRBA, 2006, pp. 6-7). In making this determination, however, it is acknowledged that the auditor is not a legal expert (IAASB, 2009h; IAASB, 2009g). As such, whether or not a particular act or omission constitutes a reportable irregularity due to its being 'unlawful', will generally be based upon the advice of an informed expert qualified to practise law and may very well only be resolved by the appropriate court of law (IRBA, 2006).

What is key for an auditor is the fact that he only has the duty to report the 'unlawful act or omission' under s45 of the APA where, based on professional judgement, he has *prima facie* evidence that causes him 'to be satisfied' or 'have reason to believe' that the 'unlawful act or omission' meets the definition of a 'reportable irregularity' (IRBA, 2006, p. 7). Further examination of this matter is beyond the scope of this research.

### **'Responsible for management'**

For an 'unlawful act or omission' to trigger a reportable irregularity, it needs to be undertaken by those 'responsible for the management of the entity' (s1 of the APA, 2005). While the APA does not define this term, it does provide a definition for 'management board'. This would imply that the person responsible for the management of an entity will probably be somebody with the responsibilities and duties traditionally associated with the board of directors or, in relation to some other entity, the equivalent governing body (s1 of the APA, 2005; Gawith, 2006; IRBA, 2006; PwC, 2006).

The IRBA (2006) and IAASB (2009b) suggest that the person responsible for management of an entity would normally, either individually or as a group, be responsible for the setting of the strategic objectives and operational policies of the entity. This includes making decisions regarding the allocation of resources to ensure fulfilment of those objectives and policies and the establishment of supporting policies and processes. Such can include the selection, review and approval of accounting policies, the financial statements, and the appointing of agents to act on behalf of the company (IRBA, 2006). This implies that a person responsible for

management has an entity-wide decision making portfolio. Therefore, a branch manager, even if vested with considerable decision making authority at a local level, will not be responsible for entity-wide management and will probably not be regarded as a person 'responsible for management' as understood by s45 of the APA. This should be contrasted with an executive committee which may be tasked with the driving a firm's strategic mission. Such a body would probably be regarded as 'responsible for management' under s45 of the APA (PAAB, 2003; SAICA, 2004; IRBA, 2006).

### **Characteristics of an 'unlawful act' or 'omission'**

For an unlawful act or omission to give rise to a reporting duty under s45 of the APA, it must have caused, or be likely to cause, material financial loss to the entity or certain stakeholders in respect of their dealings with the respective entity. Alternately the 'act or omission' should amount to a material breach of fiduciary duties owed to such persons. An act of fraud or theft, irrespective of its materiality, would also characterize the act or omission as reportable (s1 of the APA, 2005; Gawith, 2006; IRBA, 2006; PwC, 2006; Wielligh, 2006).

For this purpose, the IRBA (2006, p. 15) suggests that 'fraud is the unlawful and intentional making of a misrepresentation which causes actual prejudice or which is potentially prejudicial to another'. Likewise, theft is the 'unlawful taking of a thing which has value with the intention to deprive the owner...of that thing'. A breach of fiduciary duty amounts to a failure to act solely for the benefit of the respective stakeholder and a failure to avoid potential conflict of interests (IRBA, 2006; IOD, 2009).

What is important to note is that management's act or omission need only be characterized by one of these traits to trigger a reporting duty under s45 of the APA (Gawith, 2006; IRBA, 2006; Wielligh, 2006). If, for example, an act or omission has caused or is likely to cause financial loss, then it is necessarily reportable. If the act or omission is not expected to give rise to a material financial loss, the auditor would consider whether or not the other two conditions are applicable (IRBA, 2006). For this purpose, the determination of whether or not financial loss or a breach of fiduciary duty is material would require the application of professional judgement and the consideration of both quantitative and qualitative factors (IRBA, 2006; IAASB, 2009s; IAASB, 2009n). In making such an assessment, however, the auditor should not take into account any benefit that might arise from the irregularity.

To conclude that an act of bribery, for example, may not be a reportable irregularity on the basis that the dealing is profitable as a whole would be contrary to the spirit of the legislation and the good name of the profession (SAICA, 2004; IRBA, 2006; IRBA, 2011).

---

## **A2: DUTIES OF THE AUDITOR TRIGGERED BY S45 OF THE APA**

---

The following section elaborates on the reporting duty as summarised in Section 2.1.

### **Initial reporting**

In terms of s45 of the APA, where ‘an individual registered auditor of an entity’ (an auditor) is satisfied or has reason to believe that a reportable irregularity has taken or is taking place in respect of that entity, he must, without delay, send a written report to the IRBA (s45(1)(a) of the APA, 2005) (See also A6 below). In addition, the APA requires that:

‘The report must give particulars of the reportable irregularity... and must include such other information and particulars as the registered auditor considers appropriate’ (s45(1)(b) of the APA, 2005).

In considering whether or not an act or omission is reportable, the auditor is required to take cognizance of all information which comes to his attention, irrespective of the source of the information (s45(5) of the APA, 2005). This is true even for information which would otherwise have been protected by confidentiality or which is brought to the auditor’s attention by third parties (IFAC, 2006; IRBA, 2006). For example, any criminal conduct alluded to in the financial press would need to be considered by the auditor in deciding whether or not a duty to report under s45 of the APA has arisen (IRBA, 2006). The relevance and reliability of the source can, however, be taken into account when deciding if a reporting duty has been triggered (SAICA, 2004; IRBA, 2006).

Accordingly, the auditor may need to carry out further investigations in order to decide whether or not an act or omission amounts to a reportable irregularity. The extent of these investigations will be a matter of professional judgement. It should be appreciated, however, that the APA does oblige the auditor to design specifically and carry out audit procedures aimed at detecting reportable irregularities (IRBA, 2006; IAASB, 2009h).



Such should not, however, be used as ruse for providing the client with an opportunity to remedy the unlawful act or omission to circumvent reporting or for the auditor to ignore the presence of an actual or suspected reportable irregularity (Nel, 2001; IRBA, 2006). Therefore, once the auditor has concluded that an act or omission amounts to a reportable irregularity, s45(1) of the APA requires the auditor to report 'without delay' (Gawith, 2006; IRBA, 2006; PwC, 2006; Wielligh, 2006). A 'reasonable auditor test' would likely be applied when considering whether or not the auditor has discharged this duty. In other words, if the auditor has reported 'without delay' will depend on the time that a reasonable auditor would have taken to carry out necessary investigations before reporting was considered necessary (IRBA, 2006, p. 25).

A failure to report a reportable irregularity in compliance with s45 of the APA can lead to a fine, imprisonment or both (s52 of the APA, 2005). The APA does not, however, offer legal protection for an auditor who erroneously, but in good faith, reports a matter to the IRBA (s46 of the APA, 2005; IRBA, 2006, p. 25). A delicate balance must be achieved between ensuring that s45 of the APA is complied with and ensuring the auditor is not over zealous in his reporting to the IRBA.

### **Subsequent reporting**

With the initial report issued to the IRBA, the APA requires the auditor to notify the client within three days of the fact that a report has been issued. The auditor is expected to take reasonable measures to discuss this report with the client's management (s45(3)(a&b) of the APA, 2005). Thereafter, the auditor is required, within thirty days, to send a second report to the IRBA informing them that either the reportable irregularity has been resolved; or that it continues; or that no irregularity was taking place (s45(3)(c) of the APA, 2005).

'Reasonable measures' are not defined in the APA but the IRBA (2006, p. 31) notes that the auditor has neither the means to force management to interact with him nor the obligation to do so. He is simply obliged to afford management a reasonable opportunity to respond to the initial report issued to the IRBA.

Reasonable measures would include extending a formal written invitation to management to discuss the initial report and making reasonable meeting times available. Carrying out detailed searches for members of the management board or mass calls in the media would not be required. If the auditor has taken reasonable measures to enter into active dialogue with the

management board but he is unable to do so through no fault of his own, he cannot be prosecuted for shortcomings on the part of the management board (IRBA, 2006).

---

### A3: DUTIES OF THE IRBA

---

Under the APA,

[the] Regulatory Board must as soon as possible after receipt of a report [whereby the auditor confirms that the reportable irregularity exists and is continuing], notify any appropriate regulator in writing of the details of the reportable irregularity to which the report relates and provide it with a copy of the report' (s45(4) of the APA, 2005).

For this purpose, an 'appropriate regulator' could include 'national government departments, regulators, agencies... [or similar institutions]' (s1 of the APA, 2005). The reportable irregularity may be investigated as necessary by the relevant authority. This may include investigations by the Director of Public Prosecutions and other organs of State which have been set up to combat fraud and corruption (IRBA, 2006). A more detailed discussion of the nature, timing and extent of further investigations and subsequent duties of the auditor is beyond the scope of this research report.

---

### A4: EXAMPLES

---

The following section is intended to provide examples of the issues which could constitute a 'reportable irregularity'. The examples are not intended to be all-inclusive.

#### **Basic example of a reportable irregularity**

During the year, the auditor discovers that his client has not paid income tax. The person responsible is the branch financial manager. In this case, no reportable irregularity exists. The failure to pay over normal tax is an unlawful omission on the part of the client. It could result in material financial loss (fines) to the client. The omission does not, however, involve the client's management board. Therefore, no duty to report to the IRBA arises (Adapted from IRBA, 2006).

### **Determination of whether or not an act or omission is unlawful: Dual audits**

It might be the case that more than one auditor is responsible for a particular audit. This can occur, for example, where a company appoints two audit firms - a so-called 'joint audit'. In such circumstances, the duty to consider whether an unlawful act or omission amounts to a reportable irregularity will lie with each individual auditor (IRBA, 2006: 8). Where both registered auditors are 'satisfied' or have 'reason to believe that the unlawful act or omission' meets the definition of a 'reportable irregularity', each auditor may be required to report to the IRBA under s45 of the APA. Alternately, a combined report may be issued by the auditors.

In a situation where only one of the registered auditors is of the opinion that there is a reportable irregularity, he is obliged to report the matter to the IRBA. The fact that the other auditor is of the opinion that there is no reportable irregularity does not detract from the responsibilities of the first auditor in terms of s45 of the APA. The onus to report ultimately rests with each individual auditor. In such a case, however, the IRBA recommends that a copy of the report be sent to the other auditor who averred that there was no reportable irregularity.

*(Adapted from IRBA, 2006)*

### **Cross-border audits**

In the context of growing globalization, audit firms are increasingly being called upon to engage in cross-border audits (IFAC, 2006; IRBA, 2006). Unlike SOX, the APA does not apply to jurisdictions outside South Africa (Maroun and Gowar, 2013). The IRBA (2006), therefore, provides guidance as to how s45 of the APA would operate in these cross-border audits.

#### **Example 1**

A holding company is a South African entity for legal purposes. The auditor identifies an act or omission of a foreign subsidiary of that holding company which amounts to a breach of South African law or a law of that foreign country. Local (South African) management was involved in the underlying act or omission. In such a situation, the auditor would have the responsibility to report the irregularity in relation to the South African holding company. There is no duty to report the irregularity in respect of the foreign subsidiary as s45 of the APA does not apply outside of South Africa.

## Example 2

It was discovered that the operations manager of an audit client in Country X, and a subsidiary of a South African company, was paying bribes to government officials in Country X in order to obtain government tenders. On further investigation, it was discovered that the subsidiary's manager was instructed to commit these acts by the operations manager in Country X as this is common business practice in Country X. This is a breach of law in Country X. Does this act amount to a reportable irregularity?

- The act is not regarded as one perpetrated by a person responsible for the management of the South African entity. Although the bribery of the government officials is regarded as unlawful, in this case, the 'unlawful act or omission' was executed on the part of management in Country X.
- It can be argued that the bribery of government officials could result in material financial loss to the entity. This could come in the form of fines; other penalties imposed by the State; the loss of customer goodwill; or impaired sustainability due to weak ethical business conduct. It may also be suggested that the bribery of public officials amounts to a material breach of fiduciary duties on the part of management in Country X.
- In making an assessment of whether or not the act in question is likely to cause material financial loss, the auditor should not take into consideration any benefit that is expected to result from the unlawful act or omission. For the auditor to conclude that the net present value of the transaction tainted by bribery is positive, and, thus, to the ultimate benefit of the stakeholders, would clearly not be in line with the spirit of the legislation and the ideals of transparency and ethics enshrined in King-III.
- The conclusion is that there is no reportable irregularity. The reason for this is that the unlawful act or omission was not attributable to the South African company. As a result, there is no duty on the part of the auditor to report the issue to the IRBA. Due to the fact that s45 of the APA does not apply in Country X, there is also no duty on the part of the auditor to report to the authorities of Country X under the APA. It should be noted, however, that other laws or regulations - such as anti-corruption or terrorism legislation - may impose a duty on the auditor to report this issue to the authorities in Country X. This is, however, beyond the scope of this thesis.

### Example 3

Assuming the same information as in Example 2, except that the subsidiary is as a South African entity:

- As discussed in Example 2, the act would be one which is unlawful and giving rise to a material breach of fiduciary duty or financial loss.
- In this instance, the subsidiary would be South African. The branch manager may very well be regarded as a person responsible for the management of the subsidiary and, therefore, a reportable irregularity may result. If not, even though the act or omission is unlawful and could result in material financial loss or breach of fiduciary duty, no reporting obligation under s45 of the APA results.
- If this manager is not responsible for the management of the parent company, there is no reportable irregularity at the parent company level. Although the act of bribery would probably otherwise have given rise to a reportable irregularity, it has not been perpetrated by those responsible for management at a group or parent company level. If, however, the subsidiary's manager was acting on the orders of the parent company's management board, there could be a reportable irregularity at a parent company level. The auditor may consider the need for legal counsel.

*(Adapted from IRBA, 2006)*

---

## **A5: ADDITIONAL CONSIDERATIONS**

---

It should be appreciated that the registered auditor only has an obligation to report an irregularity in respect of an audit client (IRBA, 2006). Section 1 of the APA defines an 'audit' as:

'[the] examination of, in accordance with prescribed or applicable auditing standards:

- a. financial statements with the objective of expressing an opinion as to the fairness or compliance with identified financial reporting framework and any applicable statutory requirements; or
- b. financial and other information, prepared in accordance with a suitable criteria, with the objective of expressing an opinion on the financial and other information'

The first part of the definition refers to the audit of financial statements. The IRBA (2006) has maintained that a duty to report would also apply to a review carried out in terms of *ISRE 2410: Review of Interim Financial Information Performed by the Independent Auditor of the Entity* (International Standards on Review Engagement [ISRE] 2410) (IAASB, 2009z). The engagement would provide only a moderate level of assurance but does, nevertheless, lead to the auditor expressing an opinion on the financial statements.

Even if it was maintained that ISRE 2410 (IAASB, 2009z) does not result in the auditor expressing an opinion on the financial statements, what is important to note is that for s45 of the APA to be applicable, the capacity within which the auditor operates is not important. Despite the fact that the auditor provides his client with only a review service, he is ultimately responsible for the audit of the financial statements of that client (IRBA, 2006). This, together with the fact that the auditor is obliged to consider all information that comes to his attention when concluding on whether or not to report, implies that s45 of the APA could apply to such review engagements (IRBA, 2006).

Where an engagement is undertaken within the scope of *ISRE2400: Engagements to Review Financial Statements* (ISRE 2400) (IAASB, 2009y) a different conclusion may be reached. The IRBA (2006) suggests that in such a situation, the practitioner is not the auditor of the client but is providing only a review service. This is in contrast with an engagement undertaken in terms of ISRE 2410 (IAASB, 2009z) where the practitioner is the client's appointed auditor and happens also to provide a review service to the client. Due to the fact that the practitioner provides only moderate assurance, one interpretation of the definition of 'audit' per s1 of the APA leads to the conclusion that s45 of the APA does not apply (IRBA, 2006).

Looking at the ordinary meaning of 'express an opinion' in s1 of the APA, however, the conclusion that s45 of the APA continues to apply is possible. Despite the fact that ISRE 2400 (IAASB, 2009y) deals with a review engagement where only moderate assurance is provided, the practitioner may, nonetheless, be regarded as giving an opinion on the financial statements, albeit that the opinion is stated in the negative (s1 of the APA, 2005; IAASB, 2009y; IAASB, 2009z). Further discussion of this difference in application of s45 of the APA is beyond the scope of this study (for details see Maroun and Wainer, 2013).

The second part of the definition of an 'audit' per s1 of the APA would apply in the case of an audit of other information, be it financial or non-financial information, with the exception of financial statements (IRBA, 2006). It is, thus, submitted that special purpose engagements

within the scope of *ISAE 3000: Assurance Engagements other than Audits or Reviews of Historical Financial Information* (International Standards on Assurance Engagements [ISAE] 3000) (IAASB, 2009u) or *ISAE 3400: The Examination of Prospective Information* (ISAE: 3400) (IAASB, 2009v) could fall within the scope of s45 of the APA.

In contrast with audits, an agreed-upon procedure engagement or an engagement to compile financial information falls within the scope of *International Standards on Related Services* (ISRS) and does not require the auditor to express an opinion (IAASB, 2009aa). For this reason, the engagement would not meet the definition of an 'audit' and would thus not trigger a reporting duty in terms of s45 (IRBA, 2006). What is important to realise, however, is that if the auditor is providing services to a client that would not otherwise have been regarded as an 'audit' per s1 of the APA, but that client happens also be an audit client, then s45 of the APA would continue to be relevant. For example: if an audit firm is carrying out a forensic investigation at a client (as an agreed upon procedure) and is satisfied or has reason to believe that there is a reportable irregularity, this could trigger a duty to report if the firm is also the client's auditor. Even if the client for whom the agreed-upon procedures were carried out was not an audit client but the matter in question related to an audit client, this could give rise to a duty to report. The reason for this is that the individual registered auditor is obliged to take into account all information from all sources which comes to his attention in deciding whether or not to report to the IRBA (IRBA, 2006).

---

## A6: EXAMPLE OF THE FIRST REPORT TO THE IRBA

---

### *LETTERHEAD OF THE RESPECTIVE AUDIT FIRM*

Adv Francois Opperman

Professional Manager: Compliance

Independent Regulatory Board for Auditors

P O Box 751595

GARDEN VIEW

2047

*Date*

Dear Sir

**NAME OF AUDITEE:** [INSERT THE NAME OF THE AUDIT CLIENT]

**REGISTRATION NUMBER:** [INSERT THE ENTITY'S REGISTRATION NUMBER]

This letter is in accordance with the requirements of the Auditing Profession Act No. 26 of 2005 (the Act), section 45 – *Duty to report on irregularities*.

My firm has been engaged by [insert name of entity] to:[Delete if not applicable]

1. Audit the company's annual financial statements.
2. Audit the entity's financial statements with the objective of expressing an opinion on their fairness within an identified financial reporting framework.
3. Audit financial and other information, prepared in accordance with suitable criteria, with the objective of expressing an opinion on the financial and other information.
4. Review interim financial and other information with the objective of expressing a limited assurance opinion on the interim financial or other information.

I have reason to believe that a reportable irregularity, as defined in the Act, has taken, or is taking place. I am not able to make a legal determination in respect of the suspected unlawful act or omission but have exercised professional judgement, based on the evidence or information which has come to my knowledge, including undertaking further investigations of information as were considered necessary in the circumstances. Particulars of the reportable irregularity are: [Provide particulars, including any other information and particulars considered appropriate]

Please acknowledge receipt of this report.

Yours sincerely [Name of registered auditor<sup>134</sup>]

Registered Auditor

Chartered Accountant (SA)

(SAICA, 2007, pp. 4-6)

---

<sup>134</sup> The registered auditor who sends this report should be the registered auditor responsible and accountable for the audit as determined in section 44(1) of the APA.



---

## A7: EXAMPLE OF THE REPORT ISSUED TO THE CLIENT'S MANAGEMENT BOARD

---

**[Firm Letterhead]**

[Date]

[Members of the management board]

[Name of entity]

[Address]

Dear Members

### REPORTABLE IRREGULARITY

This letter is in accordance with the requirements of the Auditing Profession Act, No. 26 of 2005, (the Act), section 45 – *Duty to report on irregularities*.

The Act defines a reportable irregularity as any unlawful act or omission committed by any person responsible for the management of an entity, which –

- (a) has caused or is likely to cause material financial loss to the entity or to any partner, member, shareholder, creditor or investor of the entity in respect of his, her or its dealings with the entity; or
- (b) is fraudulent or amounts to theft; or
- (c) represents a material breach of any fiduciary duty owed by such person to the entity or any partner, member, shareholder, creditor or investor of the entity under any law applying to the entity or the conduct or management thereof.

I have reason to believe that a reportable irregularity has taken or is taking place and, as required by the Act, I have reported particulars of the irregularity to the Independent Regulatory Board for Auditors (IRBA) in a written report dated [*insert date*] a copy of which is attached. As indicated in that letter, I am not at present able to make a legal determination in respect of the

suspected unlawful act or omission but have exercised professional judgement, based on the evidence or information which has come to my knowledge, including undertaking further investigations of information considered necessary in the circumstances.

The Act requires me as soon as is reasonably possible, but no later than 30 days from the date on which the individual auditor's report was forwarded to the IRBA, to send another report to the IRBA which must include:

1. A statement that I am of the opinion that:

- (a) no reportable irregularity is taking place; or
- (b) the suspected reportable irregularity is no longer taking place and that adequate steps have been taken for the prevention or recovery of any loss as a result thereof, if relevant; or
- (c) the reportable irregularity is continuing.

2. Detailed particulars and information supporting the statement above.

Please note that, where the reportable irregularity is continuing, the IRBA has a responsibility to notify any appropriate regulator in writing of the details of the reportable irregularity and to provide it with a copy of my report.

I invite you to discuss my report to the IRBA, at a meeting to be arranged as soon as possible, and at that meeting I will afford you the opportunity to make representations in respect of my report.

Yours sincerely

*[Name of registered auditor]*

Registered Auditor

Chartered Accountant (SA)

(SAICA, 2007, pp. 6-8)

---

## A8: EXAMPLE OF THE SECOND REPORT TO THE IRBA

---

**[Firm Letterhead]**

[Date]

Adv FF Opperman

Professional Manager: Compliance

Independent Regulatory Board for Auditors

PO Box 751595

Garden View

2047

Dear Sir

**SUBSEQUENT REPORT: REPORTABLE IRREGULARITY NAME OF AUDITEE:** *[INSERT THE NAME OF THE AUDIT CLIENT]*

**REGISTRATION NUMBER:** *[INSERT THE ENTITY'S REGISTRATION NUMBER]*

I refer to my report of *[date of initial report]*.

I have included a copy of the written notice which was sent, together with the abovementioned report, to the members of the management board of the entity within three days of my having sent the first written report to you. I have discussed that report with the members of the management board and have afforded them an opportunity to make representations in respect of the report. I have also undertaken further investigations as I considered necessary.

I have included written representations made by members of the management board of the entity in respect of the report. *[Delete if not applicable]*

[OR]

Although I have taken all reasonable measures to communicate with the management board in respect of the suspected reportable irregularity, the board has failed or declined to engage in discussions with me. However, I have undertaken such further investigations as I considered

necessary / I have also been unable to undertake such further investigations as I considered necessary. *[Delete if not applicable]*

I report that, in my opinion, no reportable irregularity has taken place or is taking place / the reportable irregularity is no longer taking place and that adequate steps have been taken for the prevention or recovery of any loss as a result thereof, if relevant / the reportable irregularity is continuing *[Delete if not applicable]*.

Details and information in support of my statement above are as follows:

*[Provide details and information]*

Please acknowledge receipt of this report.

Yours sincerely

*[Name of registered auditor]*

Registered Auditor

Chartered Accountant (SA)

(SAICA, 2007, pp. 8-10)

## APPENDIX B: PILOT STUDIES

---

This Appendix contains the pilot study used to test the appropriateness of the correspondence analysis (Chapter 5) and of the agenda used to administer detailed interviews.

---

### B1: PILOT OF THE CORRESPONDENCE ANALYSIS

---

#### SAMPLE AND DATA COLLECTION

---

In order to ensure the validity and reliability of the correspondence analysis, Creswell (2009) recommends the piloting of the research instrument (see also Leedy and Ormrod, 2001). This is designed to test the adequacy of the data collection process, as well as the ability of participants to complete accurately the correspondence schedule. It may also highlight unexpected events and conditions that can be remedied before the formal data collection process begins. The purpose of the pilot study is not, however, formal data analysis and interpretation and, as a result, a final correspondence analysis bi-plot is not generated using the data collected during the pilot.

#### **Sample**

The correspondence analysis was piloted at one of the Big Four Audit firms during April and May 2011 in Johannesburg, South Africa. Participants included audit managers with approximately three to five years of experience. The mean experience was 4.3 years. A total of twenty-five people were invited to participate. Of these, twenty-four (96%) completed the correspondence table correctly. One participant resigned from the respective firm during the course of the pilot study and that correspondence table was not received.

## Data Collection

The pilot study was run using the data collection strategy outlined in Section 3.4. Although the detailed interview process was not piloted at this stage, a copy of the core agenda points (Appendix B4) was included in a follow-up e-mail confirming the meeting for the completion of the correspondence table. In line with the approach used by Holland and Doran (1998), the core agenda points were provided one working week before the scheduled participation date. The correspondence tables were completed at the participants' offices and were done individually for the sake of confidentiality and to avoid group responses which may be affected by, *inter alia*, the presence of dominant members of the group or other peer pressures (Creswell, 2009; Rowley, 2012). The correspondence table (Section 3.2.2) is reproduced here for convenience.

**TABLE 3.1: CORRESPONDENCE TABLE (REPRODUCED)**

TABLE 3.1: CORRESPONDENCE TABLE (REPRODUCED)								
	Quality Trait <sup>135</sup>	Provisions of s45 of the Auditing Profession Act						
		RI's are to be reported to the IRBA	Reporting to take place immediately vs. after 30 days under the PAAA	Failure to report an RI could lead to liability and criminal sanction.	Wrongful reporting could lead to a claim for damages	RI's include fraud, irrespective of materiality level	RI's include a material breach of trust and fiduciary duty	RI's involve management only
		C1	C2	C3	C4	C5	C6	C7
R1	Development of a culture of leadership with more participation by the engagement leader (para 9)							
R2	Awareness of the importance of ethical compliance (para 14 & 18) including client acceptance and continuance procedures (para 28)							
R3	Acknowledging the importance of resources & competency of engagement team (para 36) as well as the need for full compliance with ISA (para 46)							
R4	Ensuring appropriate consultation on contentious matters and resolution of differences of opinion (para 51)							

<sup>135</sup> Paragraphs refer to the provisions of ISQC 1.

**TABLE 3.1: CORRESPONDENCE TABLE (REPRODUCED)**

Quality Trait <sup>135</sup>		Provisions of s45 of the Auditing Profession Act						
		RI's are to be reported to the IRBA	Reporting to take place immediately vs. after 30 days under the PAAA	Failure to report an RI could lead to liability and criminal sanction.	Wrongful reporting could lead to a claim for damages	RI's include fraud, irrespective of materiality level	RI's include a material breach of trust and fiduciary duty	RI's involve management only
		C1	C2	C3	C4	C5	C6	C7
R5	More attention paid to internal quality control and continuous improvement processes including documentation standards (para 74)	-						
R6	Enhanced transparency and confidence in the audit process and increased perceived value for stakeholders (including improved reporting quality)							
R7	Enhanced sustainability for audit firms including reduction in overall audit risk							
R8	A sense of legitimacy in the eyes of the informed public							
R9	A sense of personal responsibility for auditors and auditors being held to account							

Upon completion of the correspondence tables, participants were asked for their views on the data collection instrument. Most agreed that the process followed was quick and simple and that the correspondence table was easy to complete. No material omissions or other errors were noted and nothing came to the attention of the researcher to suggest that the instrument was not suitable for the purpose of the research (Appendix B2; Appendix B5).

---

## **B2: Appropriateness of the correspondence analysis**

---

Creswell (2009) and Cohen et al (2002) point to the importance of choosing the correct data collection instrument. To this end, the nature of any analysis - as well as the body of participants - should be considered when selecting a quantitative technique. As discussed in Section 3.3

and Appendix B1, participants selected to complete the correspondence table are practising accountants and auditors or auditing and accounting academics.

Observations by the researcher suggested that complex statistical techniques and data collection instruments may be foreign to many participants (see also Humphrey, 2012; Maroun, 2012a). This has two important implications: firstly, there is a risk that participants may not respond well to certain data collection techniques, leading to inaccurately completed surveys and lower response rates. Secondly, Creswell (2009) and O'Dwyer et al (2011) recommend that a copy of the final report be made available to participants for ethical and quality control reasons. If participants are not able to read and fully comprehend the report findings, this negates the benefits of providing participants with the final report. The end result is a material threat to the quality and ethical standing of the research. For this reason, the appropriateness of using correspondence analysis as the data collection instrument was briefly considered. Expanding on the results from the pilot study, the same sample of participants was asked seven 'yes' or 'no' questions. These included:

1. I would rather complete the correspondence analysis table than a questionnaire.
2. I prefer using an 'X' to mark single cells to completing a scale moving from 'strongly agree' to 'strongly disagree'.
3. I want the correspondence sheet or questionnaire to fit a single page.
4. Given the aims of the research, I think that the correspondence analysis is appropriate.
5. If I were e-mailed the correspondence table to complete, I would complete it honestly, accurately and promptly.
6. Looking at the correspondence table, I am comfortable that there are no material ethical concerns for participants.
7. If I were to receive a copy of the report, I would prefer reviewing a two-dimensional graph rather than comprehensive statistical analysis.

For the purpose of answering these questions, participants were, after the completion of the correspondence table discussed in Appendix B1, provided with an equivalent questionnaire. For this purpose each of the row headings in Table 3.1 above was re-formatted into a questionnaire using a five point likert scale. The questionnaire was limited to the same number of questions as in the correspondence table to prevent the length of the questionnaire being the main determinant when choosing a preferred data collection instrument. A questionnaire with this design was chosen as the alternative data collection instrument due to its frequency of its use in

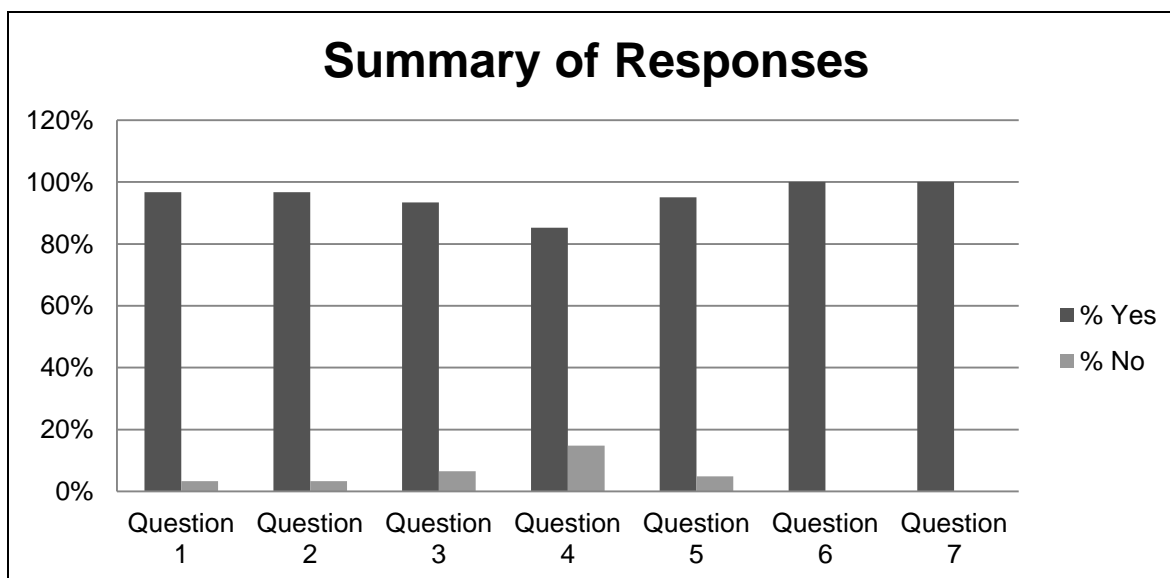


the prior literature (see, for example, Porter, 1993; Brennan and Kelly, 2007; Creswell, 2009; Steenkamp et al, 2009; Collis, 2010)<sup>136</sup>. The responses are summarized in the charts below.

### **Results and commentary**

The results suggest a strong support for the correspondence analysis. Ninety-seven percent of participants in the pilot study preferred a correspondence table to the detailed questionnaire (Question 1) and using an 'X' to mark corresponding cells, rather than the five-point Likert scale (Question 2). A total of 93% confirmed that the data collection instrument should fit a single page (Question 3). In summary, 85% of participants felt that the correspondence table was appropriate for the research (Question 4). Confirming the findings from the pilot study's quality control checklist (Appendix B5), 95% of respondents indicated that they would complete the correspondence table honestly and promptly (Question 5). Participants were unanimous in their view that there were no ethical concerns (Question 6) and that they would prefer reviewing a final report including the two-dimensional plot similar to that shown in Figure B2 to a comprehensive statistical analysis (Question 7).

**FIGURE B2: SURVEY RESPONSES: APPROPRIATENESS OF USING A CORRESPONDENCE ANALYSIS**



<sup>136</sup> The purpose of this extended 'test' was to give the researcher a sense of how well participants would respond to the questionnaire and not to constitute a formal analysis of different quantitative research techniques.

**FIGURE B2: SURVEY RESPONSES: APPROPRIATENESS OF USING A CORRESPONDENCE ANALYSIS**

Number	Details
Question 1	I would rather complete the correspondence analysis table than a questionnaire.
Question 2	I prefer using an 'X' to mark single cells to completing a scale moving from 'strongly agree' to 'strongly disagree'.
Question 3	I want the correspondence sheet or questionnaire to fit to a single page.
Question 4	Given the aims of the research, I think that the correspondence analysis is appropriate.
Question 5	If I were e-mailed the correspondence table to complete, I would complete it honestly, accurately and promptly
Question 6	Looking at the correspondence table, I am comfortable that there are no material ethical concerns for participants.
Question 7	If I were to receive a copy of the report, I would prefer reviewing a two-dimensional rather than a comprehensive statistical analysis.

### **Summation**

Although the pilot study and informal survey did not draw on the perceptions of a large number of participants, the intention is not the extrapolation of the findings or execution of formal research on the use of different data collection instruments. Rather, the pilot study and informal survey have been used to test the appropriateness of the quantitative data collection instrument in the context of this study only. To this end, nothing has come to the attention of the researcher to suggest that the correspondence analysis is not well suited to this study<sup>137</sup>.

<sup>137</sup> To further test the appropriateness of correspondence analysis, traditionally applied in a marketing context (Bendixen, 1996), a correspondence analysis was used by the researcher in a comparable interpretive context and presented at the SAAA Conference (2010) (see also Maroun et al (2011)).

---

### B3: PILOT OF THE DETAILED INTERVIEWS

---

This research focuses on the perspectives of those who are directly involved with audit and have been contributing to the development of audit practice in South Africa. Semi structured interviews (Section 3.2) are the primary data collection instrument. Respondents included audit partners as well as informed users of audit reports with several years of experience and, in several cases, included some of the leading minds in South African audit and corporate governance circles (Section 3.3)<sup>138</sup>. This gives additional assurance that the research produces relevant and reliable insights (Creswell, 2009; O'Dwyer et al, 2011).

To ensure that the detailed interviews ran smoothly; that the questions posed were suitable for the purpose of this research; and that any errors in the proposed interview agenda were identified and corrected, the data collection and analysis process, discussed in Section 3.4 was piloted (Creswell, 2009; Rowley, 2012). For the purpose of the pilot study, four interviews of between 45 minutes and three hours were conducted in Johannesburg and Pretoria during April 2011. Two respondents were from one of South Africa's Big Four audit firms and two were from a leading South African university.

The interview agenda was used flexibly to guide the interviewee. This allowed the interview process to be relatively unstructured to ensure detailed discussion while retaining focus on the purpose of the research. Questions were, as much as possible, neutral and non-leading (Creswell, 2009). At the same time, respondents were, on occasion, asked to explain a particular concept or statement in different words or from different perspectives to address 'script coherent expressions' or resolve any ambiguities (Alvesson, 2003). The tone was professional and non-intrusive. Although the sequence in which the issues were addressed – as well as the detail provided by each respondent – varied, the same themes were covered during each interview and the same point was used to commence each interview, namely: a brief discussion on the purpose of the RI provisions.

---

<sup>138</sup> The research uses 'U1-13' and 'E1-16' to identify the user and expert interviewees respectively, which exclude participants in the pilot study.

### **Data analysis**

Data analysis was by means of a 'data analysis spiral' (Leedy and Ormrod, 2001; Rowley, 2012) as discussed in Section 3.4. No follow-up sessions and resulting reclassification of data took place as the purpose of the pilot was simply to 'test' the broad axial codes discussed in Section 3.2 and Section 3.4. Preliminary notes on the different phrases, principles and concepts were, however, made to summarise each transcript and to generate a template 'code register' or 'legend' to allow for easier data analysis when the primary interviews commenced.

At this stage, no material issues were noted. In particular, preliminary analysis of the pilot transcripts suggested that the interview agenda was sufficiently broad to address each of the research questions while balancing the need to avoid excessively lengthy interviews (Rowley, 2012).

---

## **B4: AGENDA FOR DETAILED INTERVIEWS**

---

As recommended by Holland (1998a), a brief agenda should be provided to participants several days before the interview as a matter of courtesy and to allow them to prepare. The agenda should not be in such detail that it allows participants to rehearse responses (Alvesson, 2003; Rowley, 2012). A more detailed agenda is, however, used by the researcher to manage to the interview process, although this agenda is not provided to the interviewee.

---

## **CORE AGENDA FOR EXERTS**

---

### **1: Introduction**

- Note of thanks.
- Position in the firm and number of years of experience.
- Brief discussion of prior experience including the nature and number of clients and background of the audit firm.
- If part of international firm, discussion of the extent of local discretion in conduct of audits.

## 2: Discussion Points

1. **Ethical Issues:** What, in your opinion, have been the implications of s45 of the APA on the relevance and importance of adherence to ethical principles for your audit engagements?
2. **Leadership responsibility:** Have the duties under s45 of the APA and the risk of penalties for failing to comply with these duties led to you spending more time at audits and playing a greater leadership role on your audits?
3. **Human resources:** In your opinion, does s45 of the APA and its associated risk of penalties for non-compliance lead you to regard human resource practices at your firm as more or less important and why?
4. **Client acceptance and continuance:** Do you think that s45 of the APA leads to a more robust client acceptance and continuance review process and why?
5. **Documentation and audit evidence:** In your opinion, has the application of s45 of the APA caused a change in the nature, timing and extent of your audit work and documentation? Why or why not?
6. **Monitoring and continuous improvement:** Does s45 of the APA make your firm more aware of the need for continuous monitoring and improvement? Has it led to a change in your firm's values? Why do you have these views?
7. **Overall impression:** What value do you think there is in having s45 of the APA and why do you have these views? If you could change the APA, what would you change? Having detected an RI, do you feel that, on the whole, the firm would have been better off if no RI had been found at all?
8. **Structure and purpose of RI's:** Why does s45 of the APA exist? Why do you think the legislation specifically requires auditors to report irregularities without delay to the IRBA? Do you think that there is an added sense of transparency and accountability due to the reporting duty? Would you delete s45 of the APA?
9. **Standing of the Profession:** Do you think that s45 of the APA was introduced to add to the standing or credibility of the audit profession?

## CORE AGENDA FOR USERS

---

The audit process is a highly technical one (for example, see IAASB, 2009c; Ernst&Young, 2010; FRC, 2010; PwC, 2010; FRC, 2011). Together with the application of professional judgement, the result is that audit is rendered 'opaque' for non-experts (see Power, 1994; Power, 2003; Humphrey, 2012). For this reason, users may not be able to respond to the same detailed questions provided in the first agenda. To assess the perceived impact of s45 of the APA on audit quality, the following agenda is used:

### 1: Introduction

- Note of thanks.
- Position in the firm and number of years of experience.
- Brief discussion of prior work experience and employer background.
- If part of international firm, discussion of the extent of local discretion in conduct of audits.

### 2: Discussion Points

1. **General questions:** Has your audit firm explained what a 'reportable irregularity' is and what their duties are in connection with reportable irregularities?
  - Had you ever heard of 'reportable irregularities before'? What was your first reaction when you were told about the audit firm's reporting duties?
  - If you were told that the number of RI's reported had increased considerably over time, why would you think this is the case?
2. **Ethical Issues:** Have you noticed a change in the audit firm's independence practices? Do audit firms seem to placing more or less emphasis on independence and what do you think the reasons for this are?
3. **Leadership, human resources, documentation and client acceptance and continuance:** What do you think the impact of s45 of the APA and its associated penalty provisions are on audit firms? If you were a partner:
  - would you be more or less involved on an audit? How would you change the process of recording your audit evidence if at all?
  - would you change the staff complement and supervision/monitoring process?

- would you be more or less concerned about accepting new clients? How and why would you make changes, if any?
4. **Overall impression:** On the whole do you think that s45 of the APA has changed the way that auditors carry out engagements?
- Do you think that s45 of the APA has allowed you to rely more on the audit report?
  - Do you believe that auditors, having found an RI are interested in proposing solutions to resolve the underlying problem?
  - Do you have the impression that they wished they had never found the RI and why? Why do you think they adopt this outlook?
  - If you could change s45 of the APA, what would you change?
  - Would you delete s45 of the APA?

---

## DETAILED QUESTIONS FOR MANAGEMENT OF INTERVIEWS

---

The following agenda was used to prompt additional responses from interviewees during the course of the interview. These points were **not** provided to the interviewee in advance and were used only to stimulate additional discussion or ensure focus on the research questions as needed.

### **Complementary Agenda Points**

1. **Ethical Issues:** What implications have s45 of the APA had on the perceived relevance and importance of adherence to ethical principles on a statutory audit engagement?
  - Have the reporting responsibilities of s45 led to an increased drive to ensure that staff complies with ethical obligations laid out by the *IFAC Code of Conduct* and/or the audit firm's internal ethical standards?
  - How would the reaction to an ethical failure be different if there was no s45 of the APA?

- Have independence requirements in connection with listed entities become more onerous due to RI's and MI's and what are the differences due to changes in the legislation?
  - How has the introduction of s45 led to changes, if at all, in the firm's ethical standards? In other words, did the replacement of the MI's by RI's lead to a refinement of ethical standards?
  - Do partners feel that a breach of independence would be more or less significant due to the fact that RI's have replaced MI's?
  - In connection with the above, do partners believe that either RI's or MI's would cause a breach of independence to be any more severe than if these sections had never been introduced?
  - What would the implications for ethics in the auditing profession be if the reporting obligations of s45 were repealed?
2. **Leadership responsibility:** Do the provisions of s45 of the APA cause engagement leaders to take a greater leadership responsibility role on statutory audits?
- Do partners feel that s45 of the APA has led to increased involvement in the audits and to partners accepting a greater degree of responsibility for audits?
  - How has this changed due to the replacement of material irregularities (MI's) with reportable irregularities (RI's)?
  - What drives leadership responsibility at the audit firms?
  - What would the implications for leadership responsibility be if the provisions of s45 of the Audit Profession Act (APA) were to be removed?
3. **Human Resources:** What are the implications of s45 of the APA on the perceived importance of human resource practices? In particular, what are the implications for the perceived importance of the skill and competency of engagement team members as well as the adequacy of time and resources available to those team members to execute an engagement?
- Has there been increased training to ensure that partners have the necessary skill and competency to carry out engagements?
  - Was this training limited to dealing simply with the provisions of s45 or did s 45 lead to other training requirements? In other words, has s45 led to an increased drive to ensure that general improvements in audit quality are made?



- The above two questions should be asked in connection with the training of junior staff.
- Is more consideration given to the composition of the engagement team and to the time allocated to carry out the audit engagement due to the fact that s45 establishes reporting obligations on the firm? Are these considerations the direct result of the RI provisions or are they a by-product of the firm's quality mechanisms?
- How is the need of ensuring that adequate consultation takes place on an engagement affected by the provisions of s45? Were there any changes in this regard when RI's replaced MI's?
- To what extent are partners concerned that staff on audit assignments lack adequate skills to carry out the audit? Has this changed due to the replacement of RI's with MI's? Is the concern driven by brand preservation only? Do RI's cause partners to value highly skilled staff more?
- Have RI's and MI's had any implication for human resource practices?
- What is the effect of the potential increase in the exposure to civil and criminal sanctions due to the replacement of MI's by RI's?

**4. Client Acceptance and Continuance:** Does s45 of the APA lead to a more robust client acceptance and continuance review process and how does this interface with the need for risk management by audit firms?

- Has s45 led to a change in the performance and evaluation system? In other words, has this section led to changes or concerns regarding the acceptance of new clients or retention of existing clients?
- Do partners perceive a greater risk in connection with new clients because there could be RI's?
- What would happen in connection with client continuance if you found an RI? How would this be different if it were a MI?
- Do partners feel that the replacement of MI's by RI's has led to a material change in the assessment of client acceptance and continuance?
- Do the differences, if any, add value to the audit firm, the client and the general users of the financial statements?

5. **Documentation and Audit Evidence:** What was the impact of s45 of the APA on the engagement performance and documentation standards and protocols at audit firms? Is there a causal link between the existence of s45 of the APA and any changes in any aspect of the conduct of statutory audits since 2005 (when s45 came into effect), and if so, how strong is the link?
- To what extent does s45 cause partners to doubt whether or not the audit evidence obtained supports the audit opinion? How has this changed from the old MI provisions?
  - Have the audit firms reassessed the adequacy of the audit procedures that they carried out for clients? Was there a change to the internal manuals used in these firms?
  - Is more attention paid to engagement briefing? What has the impact been on the supervision, review and consultation processes?
  - Are partners more or less concerned about the effect of important judgements made during the course of the audit?
  - Have the provisions of s45 led to more detailed and comprehensive consultations? Have these provisions led to the discovery of other facts and circumstances that would have gone undetected?
  - Do you feel that the consultations are restricted simply to ensuring that statutory duties are met?
6. **Monitoring and Continuous Improvement:** has s45 of the APA led to a more comprehensive continuous improvement and strategy formulation process at the audit firm level?
- Have s45 or the old MI provisions led to a change in the performance and evaluation system?
  - Have these sections led to changes and/or concerns regarding the appointment of new partners. Do the two sections have different impacts?
  - How, if at all, does s45 impact on client relations and specifically adds to, or detracts from, the efficiency and effectiveness of the audit?
  - Has s45 driven an improvement in the quality of documented work and audit evidence obtained?

- Does the firm's quality control system (which includes continuous improvement mechanisms) been tailored to account for s45? Has s45 placed pressures on the firm to enhance its internal monitoring systems with an aim to improving quality in general? How is this different from MI's?

## **7. Quality in General:**

- Do partners feel that the reference to 'fraud', irrespective of the value concerned in the definition of an RI is appropriate? What would the effect of detecting an RI be on audit materiality? Have adjustments to materiality been made in the planning phase of the audit?
- Is it appropriate for the auditor to assess the materiality of the RI/MI where the 'materiality' in question may not necessarily be equivalent to the materiality used for the purposes of the audit? In this context, do audit partners feel that the methodology for determining materiality is appropriate or not?
- Do partners feel that RI's and MI's add value to the auditing process and to the client?
- Could the removal of the 30-day window period lead to the client and auditor being less able to resolve the underlying problem? Does this lead the client deliberately to conceal the RI?
- On the whole, do the penalty provision and additional administrative load associated with detecting an RI make you inclined to hope that audit procedures will not detect an RI?
- Do partners feel that the legislation has improved confidence in the audit profession and the image of the audit profession?
- In light of the dramatic increase in the number of RI's being reported to the IRBA as opposed to the number of MI's historically reported, what is the primary cause of this increase?
  - Is it attributable to the fact that s45 requires us to report immediately to the IRBA, as opposed to the old MI provisions which required the auditor to report to the client first?
  - Does the fact that the APA introduces a risk of imprisonment for up to 10 years or a fine stimulate additional reporting?

- Do the RI provisions and the differences between the RI and MI provisions add to improved transparency and accountability? Have the amendments added to increased reliance of key users on the client's financial reports? Have these changes led to an increase in the public's faith in the audit process?
- Has the general climate of high profile audit failures led to an increase in reporting? Are there other factors that stimulate the firm to report more?
- Do the above factors influence the need to report more than the need to ensure improved audit quality and general reliance of the public in the audit process in the context of high profile audit failures? That is, is reporting stimulated simply due to the statutory obligation?
- Do you think that it is appropriate that the RI and MI provisions apply only when acting in the capacity of an auditor?
- If South Africa had no RI or MI provisions, would this be beneficial or not and why?
- Ultimately, do partners feel that the provisions relating to RI's and MI's are useful or not?

## **8. Standing of the profession:**

- Do you think that there is a connection between s45 of the APA and regulatory developments taking place overseas?
- How important is the fact that South Africa has been ranked first globally for the quality of its auditing and accounting standards?
- Does s45 of the APA add to the credibility of the audit process? Is it an example of auditors being required to report more and does this appeal to the interests of different stakeholders?
- Do you think that the reporting duty is justifiable?
- Does s45 of the APA make sense? Is it an example of whistle-blowing and does whistle-blowing make sense?
- Do you think that the duty to report leads to an added sense of transparency or accountability from the point of view of clients and auditors?
- Do you think that s45 of the APA is a type of surveillance mechanism?

- Why are there penalties for auditors for non-compliance with the APA? Do the penalties make sense?

---

### B5: QUALITY CONTROL CHECKLIST

---

After the completion of the correspondence analysis and detailed interviews, participants were asked to provide feedback on the data collection process. This has been used to complete the quality control checklist (Table B1) below.

TABLE B1: RISK MATRIX			
Risk Area	Tested During the Pilot Study?	Positive Feedback from Participants?	Comments
Correspondence table is difficult to complete or not readily understood	✓	✓	Participants complimented the instrument for the fact that it was easy to interpret and simple to complete. No additional quality elements were noted.
Questionnaires using scales are not often well received by the audit profession	✓	✓	Participants commented that they preferred the correspondence table to questionnaires. The main reasons given were: (1) the analysis was on a single sheet;  (2) it was easier to complete and less time consuming and; (3) symbols used on the questionnaires were seen as irritating in some cases.
There were no ethical reasons that prevented completion of the correspondence analysis or detailed interviews	✓	✓	Participants were asked to comment on whether or not they perceived any threats to the fundamental principles enshrined in the IFAC Code and any internally used codes of ethics. All responded in the

TABLE B1: RISK MATRIX			
Risk Area	Tested During the Pilot Study?	Positive Feedback from Participants?	Comments
			negative.
Data collection process ought to be efficient and professional. Use of confidentiality ought to improve response sincerity	✓	✓	No negative responses were received concerning the collection process.  Participants indicated that they preferred being anonymous.
Correspondence analysis should be able to produce an easily interpreted two dimensional plot with acceptable loss of data richness	✓	✓	No issues noted – please refer to Appendix B2.
Detailed interviews shed light on the research question and provided detailed, contrasting perspectives	✓	✓	No issues noted – refer to Appendix B3 and Appendix B4.
Technical consultants should be able to easily review the manipulation and analysis of the correspondence plot and understand the arguments raised based on the detailed interviews	✓	✓	Discussion with the technical consultant based on the results of the pilot studies gave no indication that review of data manipulation and analysis would be problematic.
Material omissions detected in the correspondence analysis or detailed interviews (i.e. coverage issues noted)	✓	✓	Discussion with participants and the technical consultant as part of the peer debriefing highlighted no material omissions. The pilot study (Appendix B1; Appendix B2; Appendix B3) highlighted no issues.
Participant mortality issues	✓	✓	As discussed in Section 3.3 an adequate sample size is relied upon.

In addition to the above, this study has also followed the guidance provided in *ISA 620: Using the Work of an Auditor's Expert* (ISA 620) (IAASB, 2009r). Although ISA 620 is intended for external audit engagements, it offers insights into relying on the work of experts and has been adapted for the purpose of this study. This is summarized as follows:

<b>TABLE B2: RELYING ON THE COMMENTS OF EXPERTS AND INFORMED USERS</b>			
<b>Recommendation per ISA 620</b>	<b>Threat to validity?</b>	<b>Risk addressed?</b>	<b>Description of implementation</b>
Consider the competency, capabilities and objectivity of the participants (para 9).	✓	Yes	<ul style="list-style-type: none"> <li>• All experts and informed users have several years of relevant experience. Many participants are thought-leaders in their respective areas.</li> <li>• Participants reminded of the need for honesty and candour</li> <li>• Responses to be kept confidential for assurance purposes</li> <li>• Participants provided with interview agenda for transparency and result accuracy; agenda is brief to prevent result rehearsal</li> </ul>
Does the researcher have an understanding of the field of expertise of the chosen participants to assess commentary (para 10)?	✓	Yes	<ul style="list-style-type: none"> <li>• Detailed literature review has been completed to provide a context for the study</li> <li>• The researcher is a member of SAICA with several years of experience</li> <li>• Peer debriefing allowed for</li> <li>• Presentation of preliminary findings at formal conferences</li> </ul>
Consider the need to discuss the scope and purpose of the work of the expert (para 11).	✓	Yes	<ul style="list-style-type: none"> <li>• Participants were contacted personally and informed of the nature and scope of the research.</li> <li>• An agenda served as an interview protocol and participants were given time to prepare for the interview.</li> </ul>
Are measures in place to evaluate the adequacy and reasonableness of the expert's commentary (para 12)?	✓	Yes	<ul style="list-style-type: none"> <li>• Refer to Table 3.8 and Sections 3.2, Section 3.4 and Section 3.5.</li> </ul>

**TABLE B2: RELYING ON THE COMMENTS OF EXPERTS AND INFORMED USERS**

Recommendation per ISA 620	Threat to validity?	Risk addressed?	Description of implementation
Has appropriate reference been made to the use of experts (para 14)?	✓	Yes	<ul style="list-style-type: none"> <li>Participants will be assigned a number for referencing purposes.</li> <li>Individual identities are protected.</li> </ul>
Is the use of the work of an expert ethical (IFAC, 2006)?	✓	Yes	<ul style="list-style-type: none"> <li>Refer to Section 3.6 and Table 3.8</li> </ul>

### Conclusion

During the course of the pilot study and preliminary data collection and analysis work, nothing has come to the attention of the researcher to suggest that there are material weaknesses in the design of the correspondence analysis. This has been confirmed as part of the peer debriefing process referred to in Section 3.

## **APPENDIX C: DATA MANIPULATION AND ANALYSIS: CHAPTER 5**

This section provides additional information on the data analysis, supporting the generation of the correspondence bi-plot presented in Chapter 5 and discussed in Chapter 3. Table C1 summarises the results of the correspondence analysis. The final correspondence table resulted in a 9 active rows x 7 active columns contingency table. Plotting this in two dimensions ensures ease of interpretation and retains 81% of the data's exploratory potential<sup>139</sup>. At 48 degrees of freedom, the Chi-Square statistic of 113.9 is in excess of the critical value at the 5% confidence level, providing evidence to suggest that there is a statistically significant dependence between rows and columns. In other words, and as discussed in Chapter 4, there is a correlation

<sup>139</sup> Per Bendixen (1996), with 7 columns included in the correspondence table, the data would plot perfectly in a 6-dimensional space. This is confirmed by Table C2. Such a plot would, however, be impossible to visualise and interpret. For this reason, a trade-off exists between quality of the plot and ease of interpretation.



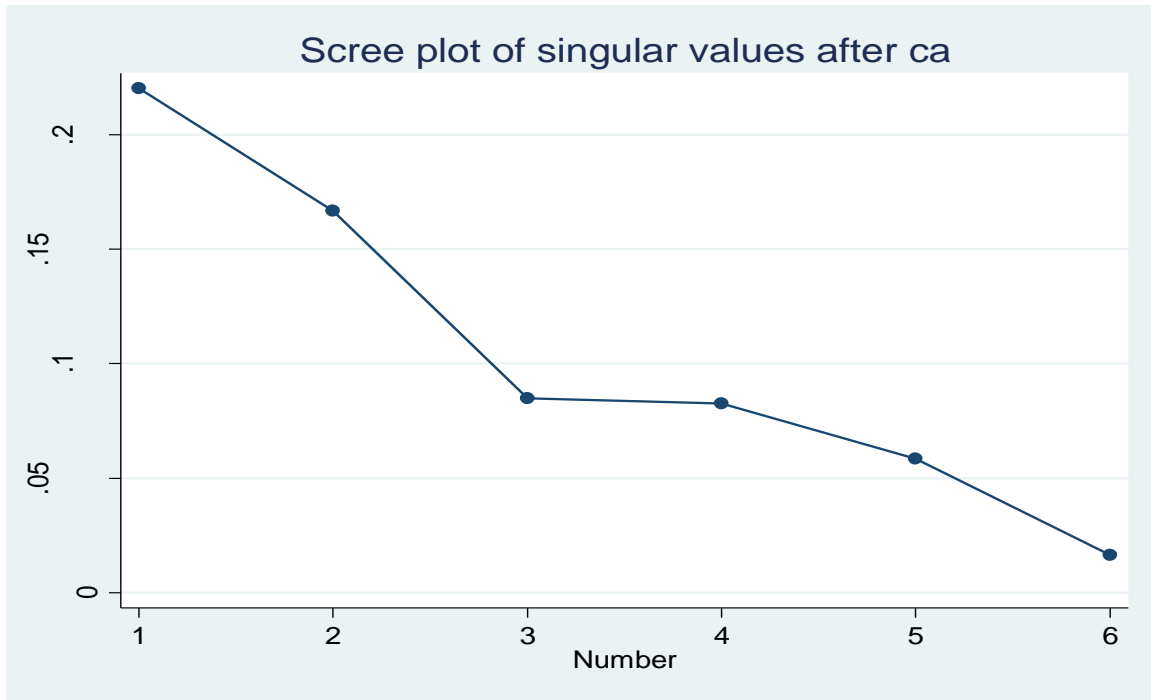
between the RI provisions and conceptions of audit quality per ISQC 1 (adapted from Bendixen, 1996; Turner and Maroun, 2010; Maroun et al, 2011).

<b>TABLE C1: DESCRIPTIVE STATISTICS FOR THE CORRESPONDENCE ANALYSIS</b>	
Active rows	9
Active columns	7
Number of observations	1203
Pearson $\chi^2(48)$	113.09
Prob > $\chi^2$	0
Total inertia	0.094
Number of dim.	2
Expl. inertia (%)	81.13

Likewise, Table C2 and Figure C1 confirm that the inclusion of additional dimensions would not have added materially to the quality of the plot given added complexity.

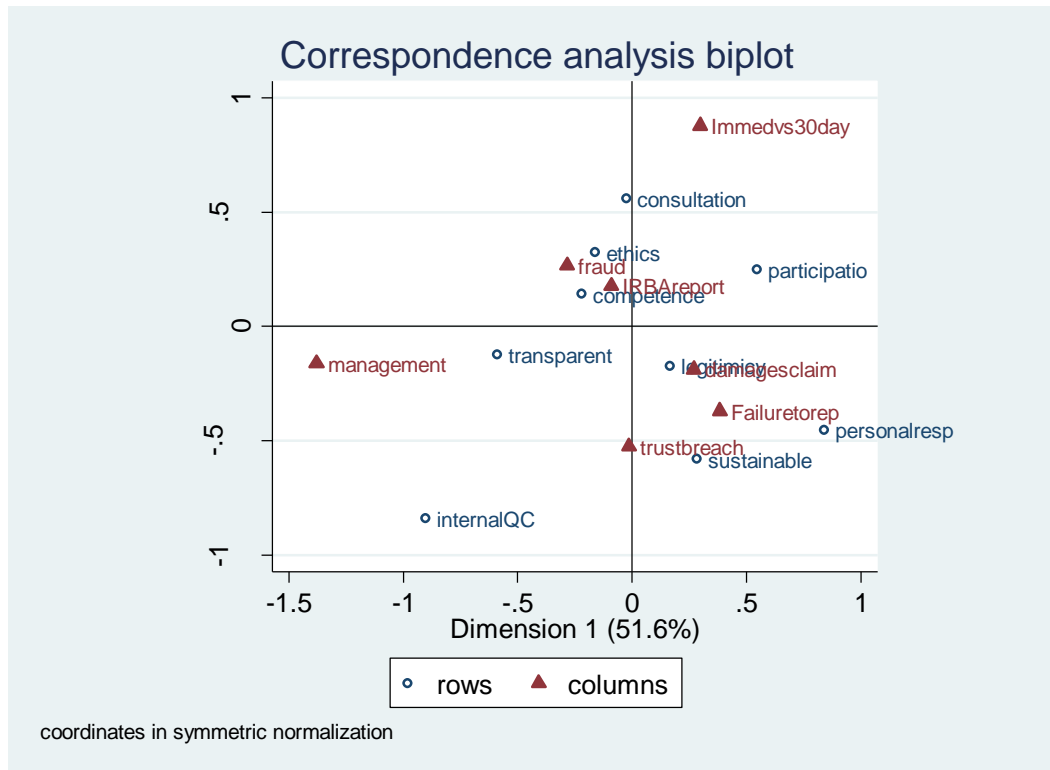
<b>TABLE C2: SUMMARY OF DIMENSIONS AND ASSOCIATED EXPLANATORY POWER</b>					
Dimension	Singular value	Principal inertia	Chi2	Percentage	Cumulative percentage
Dimension 1	0.2201609	0.0484708	58.31	51.56	51.56
Dimension 2	0.1667333	0.0278	33.44	29.57	81.13
Dimension 3	0.0849525	0.0072169	8.68	7.68	88.81
Dimension 4	0.0826398	0.0068293	8.22	7.26	96.07
Dimension 5	0.0584928	0.0034214	4.12	3.64	99.71
Dimension 6	0.0164405	0.0002703	0.33	0.29	100
Total		0.0940088	113.09	100	100

**FIGURE C1: SCREE PLOT**



The initial Stata-generated graphical representation of the correspondence analysis is presented in Figure C2.

**FIGURE C2: CORRESPONDENCE PLOT**



The plot presented in Figure C2 includes both rows and columns in the two-dimensional space. Bendixen (1996) recommends that the axes be interpreted in terms of rows with column points plotted or *vice versa*. This research seeks to examine the perceived correlation between elements of the RI provisions and quality attributes outlined in ISQC 1. As such, ‘quality traits’ serve as statement or row headings and are plotted along the x- and y-axes (which are defined by ‘elements’ of the RI provisions). These axes are interpreted according to the contribution that each row or column heading makes to the respective axis. In this instance, since there are 7 column headings, any making an inertial contribution of more than 14% is included in the final analysis and, thus, defines on the respective axes. Considering Table C4, C3 and C7 contribute 13% and 70% to Dimension 1’s total inertia respectively. Similarly, C2, C3 and C6 account for 55%, 16% and 15% of Dimension 2’s inertial load. The contributions made by C1, C4 and C5 are below average on each dimension and these column headings are, thus, excluded for the

purpose of the analysis. The result is the following axis labels for the final correspondence plot found in Chapter 5:

<b>TABLE C3: LABELLING OF THE AXES</b>	
<b>Axis</b>	<b>Label</b>
Positive x-axis (axis 1)	C3: Failure to report an RI could lead to liability and criminal sanction
Negative x-axis (axis 1)	C7: RI's involve management only
Positive y-axis (axis 2)	C2: Reporting to take place immediately vs. after 30 days under the PAAA
Negative y-axis (axis 2)	C3: Failure to report an RI could lead to liability and criminal sanction C6: RI's include a material breach of trust and fiduciary duty

The plotting of individual row headings in the now defined two-dimensional space is carried out in a similar fashion using the data found in Table C5. R1 (12%), R5 (24%), R6 (20%) and R9 (37%) each has an inertial contribution in excess of 10% with respect to the first dimension and, accordingly, is included in the bi-plot. Likewise, R2, R4, R5, R7 and R9 have inertial contribution in excess of the average and are thus plotted against the second axis<sup>140</sup> (adapted from Bendixen, 1996; Turner and Maroun, 2010; Maroun et al, 2011). The final bi-plot appears in Chapter 5 (Figure 5.1).

<sup>140</sup> R2 makes an inertial contribution of slightly less than the average expected contribution. As such, it has been included in the analysis.

**TABLE C4: STATISTICS FOR COLUMN CATEGORIES IN SYMMETRIC NORMALISATION (REPRODUCED)**

		Overall			Dimension_1			Dimension 2		
		Mass	Quality	%inert	Coord	Sqcorr	Contrib	Coord	Sqcorr	Contrib
C1	RI's are to be reported to the IRBA	0.193	0.209	0.069	- 0.091	0.053	1%	- 0.178	0.155	4%
C2	Reporting to take place immediately vs. after 30 days under the PAAA	0.119	0.91	0.206	0.298	0.12	5%	0.878	0.79	55%
C3	Failure to report an RI could lead to liability and criminal sanction.	0.194	0.971	0.117	0.384	0.57	13%	-0.37	0.401	16%
C4	Wrongful reporting could lead to a claim for damages	0.204	0.752	0.063	0.27	0.55	7%	- 0.188	0.202	4%
C5	RI's include fraud, irrespective of materiality level	0.119	0.405	0.092	- 0.284	0.244	4%	0.266	0.162	5%
C6	RI's include a material breach of trust and fiduciary duty	0.09	0.613	0.072	- 0.014	0.001	0%	- 0.525	0.612	15%
C7	RI's involve management only	0.081	0.965	0.38	- 1.379	0.955	70%	- 0.161	0.01	1%

**TABLE C5: STATISTICS FOR ROW CATEGORIES IN SYMMETRIC NORMALISATION (REPRODUCED)**

		Overall			Dimension_1			Dimension 2		
		Mass	Quality	%inert	Coord	Sqcorr	Contrib	Coord	Sqcorr	Contrib
R1	Development of a culture of leadership with more participation by the engagement leader (para 9)	0.089	0.895	0.08	0.546	0.775	12%	0.248	0.121	3%
R2	Awareness of the importance of ethical compliance (para 14 &18) including client acceptance and continuance procedures (para 28)	0.159	0.71	0.055	- 0.162	0.177	2%	0.323	0.533	10%
R3	Acknowledging the importance of resources & competency of engagement team (para 36) as well as the need for full compliance with ISA (para 46)	0.094	0.753	0.019	- 0.221	0.573	2%	0.142	0.18	1%
R4	Ensuring appropriate consultation on contentious matters and resolution of differences of opinion (para 51)	0.16	0.81	0.11	- 0.026	0.002	0%	0.559	0.808	30%
R5	More attention paid to internal quality control and continuous improvement processes including documentation standards (para 74)	0.064	0.9	0.225	- 0.904	0.544	24%	-0.84	0.356	27%
R6	Enhanced transparency and confidence in the audit process and increased perceived value for stakeholders (including improved reporting quality)	0.126	0.703	0.151	- 0.589	0.68	20%	- 0.124	0.023	1%
R7	Enhanced sustainability for audit firms including reduction in overall audit risk	0.054	0.501	0.085	0.284	0.121	2%	-0.58	0.38	11%
R8	A sense of legitimacy in the eyes of the informed public	0.14	0.547	0.03	0.165	0.3	2%	- 0.172	0.247	3%
R9	A sense of personal responsibility for auditors and auditors being held to account	0.114	0.936	0.246	0.841	0.768	37%	- 0.453	0.168	14%
					<hr/> <b>100%</b>			<hr/> <b>100%</b>		

## APPENDIX D: ETHICAL CLEARANCE CONFIRMATION

---



Warren Maroun

Department of Management

20th April 2011

Dear Warren,

**REP(EM)/10/11-51 'The Relationship between Reportable Irregularities and the Audit Quality of the South African External Audit.'**

I am pleased to inform you that the above application has been reviewed by the E&M Research Ethics Panel that FULL APPROVAL is now granted.

Please ensure that you follow all relevant guidance as laid out in the King's College London *Guidelines on Good Practice in Academic Research* ([http://www.kcl.ac.uk/college/policyzone/attachments/good\\_practice\\_May\\_08\\_FINAL.pdf](http://www.kcl.ac.uk/college/policyzone/attachments/good_practice_May_08_FINAL.pdf)).

For your information ethical approval is granted until 19th April 2013. If you need approval beyond this point you will need to apply for an extension to approval at least two weeks prior to this explaining why the extension is needed, (please note however that a full re-application will not be necessary unless the protocol has changed). You should also note that if your approval is for one year, you will not be sent a reminder when it is due to lapse.

If you do not start the project within three months of this letter please contact the Research Ethics Office. Should you need to modify the project or request an extension to approval you will need approval for this and should follow the guidance relating to modifying approved applications: <http://www.kcl.ac.uk/research/ethics/applicants/modifications.html>. Any unforeseen ethical problems arising during the course of the project should be reported to the approving committee/panel. In the event of an untoward event or an adverse reaction a full report must be made to the Chairman of the approving committee/review panel within one week of the incident.

Please would you also note that we may, for the purposes of audit, contact you from time to time to ascertain the status of your research.

If you have any query about any aspect of this ethical approval, please contact your panel/committee administrator in the first instance (<http://www.kcl.ac.uk/research/ethics/contacts.html>). We wish you every success with this work.

Yours sincerely

---

Daniel Butcher

Research Ethics Administrator



## APPENDIX E: PARTICIPANT CONSENT FORM

### CONSENT FORM FOR PARTICIPANTS IN RESEARCH STUDIES

Please complete this form after you have read the Information Sheet and/or listened to an explanation about the research.



**Title of Study:** Instigating the role of reportable irregularities in South African audit

**King's College Research Ethics Committee Ref:** REP(EM)/10/11-51

Thank you for considering taking part in this research. The person organising the research must explain the project to you before you agree to take part. If you have any questions arising from the Information Sheet or explanation already given to you, please ask the researcher before you decide whether to join in. You will be given a copy of this Consent Form to keep and refer to at any time.

Please tick  
or initial

- I understand that if I decide at any time during the research that I no longer wish to participate in this project, I can notify the researchers involved and withdraw from it immediately without giving any reason. Furthermore, I understand that I will be able to withdraw my data up to the point of publication. ☐
- I consent to the processing of my personal information for the purposes explained to me. I understand that such information will be handled in accordance with the terms of the Data Protection Act 1998. ☐
- I consent to my interview being recorded using a Dictaphone or in writing. ☐

**Participant's Statement:**

I \_\_\_\_\_

agree that the research project named above has been explained to me to my satisfaction and I agree to take part in the study. I have read both the notes written above and the Information Sheet about the project, and understand what the research study involves.

**Signed**

**Date**

**Investigator's Statement:**

I \_\_\_\_\_

Confirm that I have carefully explained the nature, demands and any foreseeable risks (where applicable) of the proposed research to the participant.

**Signed**

**Date**

## APPENDIX F: LIST OF PARTICIPANTS

TABLE F1: LIST OF INTERVIEWEES		
#	Type	Job title or description <sup>141</sup>
1	Expert 1	Audit Partner
2	Expert 2	Audit Partner
3	Expert 3	Audit Partner
4	Expert 4	Audit Partner
5	Expert 5	Audit Partner
6	Expert 6	Audit Partner
7	Expert 7	Audit Partner
8	Expert 8	Audit Partner
9	Expert 9	Audit Partner
10	Expert 10	Audit Partner
11	Expert 11	Audit Partner
12	Expert 12	Audit Partner
13	Expert 13	Audit Partner
14	Expert 14	Audit Partner
15	Expert 15	Audit Partner
16	Expert 16	Audit standards, compliance, internal reviewer or external reviewer
17	Expert 17	Audit standards, compliance, internal reviewer or external reviewer
18	User 1	Audit standards, compliance, internal reviewer or external reviewer
19	User 2	Audit committee member
20	User 3	Audit standards, compliance, internal reviewer or external reviewer
21	User 4	Audit committee Member/Investor

<sup>141</sup> Job titles and descriptions have been altered to preserve the identity of respondents. A distinction between participants is for transparency only. It is not the intention of this research to explore variations in the perceptions of different classes of users and experts as discussed in Section 1.4.2.

TABLE F1: LIST OF INTERVIEWEES		
#	Type	Job title or description <sup>141</sup>
22	User 5	Audit Committee Member
23	User 6	Audit standards, compliance, internal reviewer or external reviewer
24	User 7	Audit standards, compliance, internal reviewer or external reviewer
25	User 8	Audit Committee Member
26	User 9	Institutional investor
27	User 10	Institutional Investor
28	User 11	Institutional Investor
29	User 12	Audit standards, compliance, internal reviewer or external reviewer
30	User 13	Audit standards, compliance, internal reviewer or external reviewer

## APPENDIX G: LIST OF CONFERENCE PROCEEDINGS AND RELATED PUBLICATIONS

---

As discussed in Section 3.5, several aspects of this thesis have been presented either at conferences or form part of related publications in peer review journals. A list of conference proceedings is provided below:

<b>TABLE G1: LIST OF CONFERENCE PROCEEDINGS</b>		
Name of conference	Date	Location
PhD Colloquium – King’s College London	May 2012	London, United Kingdom
PhD Colloquium – King’s College London	May 2011	London, United Kingdom
British Accounting and Finance Association	April 2012	Brighton, United Kingdom
Critical Perspectives on Accounting	June 2011	Florida, United States of America
Southern African Accounting Association	June 2010	George, South Africa
International Corporate Governance Conference	October 2012	Johannesburg, South Africa
Africa Leads Conference	November 2012	Stellenbosch, South Africa

### III: GLOSSARY OF TERMS

---

In addition to the definitions found in Section 1.3, the following frequently used terms have meanings specified:

- **Agreed-upon procedures** refer to an engagement where an auditor carries out procedures (often similar to audit procedures) which the auditor, the client and appropriate third parties have agreed to. The auditor issues a report of factual findings. No assurance is provided. The recipients of the report draw their own conclusions from the auditor's report (IAASB, 2009b; IAASB, 2009aa).
- **Audit firm:** a sole practitioner, partnership or corporation or other entity of professional accountants (IAASB, 2009b)
- **Audit quality:** is the joint probability of detecting and reporting material financial statement errors (DeAngelo, 1981a; DeAngelo, 1981b; Palmrose, 1988). For the purpose of this thesis, 'audit quality' is evidenced by the extent of adherence to the principles outlined in ISQC 1 (Section 2.2.2).
- **Audit risk:** the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated (IAASB, 2009b; Kaplan and Williams, 2012).
- **Auditor:** an individual registered with the **Independent Regulatory Board for Auditors** to carry out **audits** (as defined in Section 1.3).
- **The Big 4:** in alphabetical order, Deloitte, Ernst & Young, KPMG and PricewaterhouseCoopers
- **Confidentiality:** to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, to not disclose any such information to third parties without prior and specific authority, unless there is illegal or professional right or duty to disclose the information in question. The duty of confidentiality includes the prohibition on using information for the personal advantage of the individual **auditor** or third-party (IFAC, 2006; IRBA, 2011; SAICA, 2012).
- **Engagement leader:** see – *partner*
- **Expertise:** skills, knowledge and experience in a particular field (IAASB, 2009b)

- **Fiduciary duty:** the legal duty of a fiduciary to act in the best interests of the beneficiary; the obligation to act solely for the benefit of another party and to avoid a conflict of interest between his or her own interests and those of the other party (IRBA, 2006)
- **Fundamental principles:** those principles laid out by the Code of Professional Conduct issued by the International Ethics Standards Board for Accountants (see also IFAC, 2006). These include: **integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.**
- **Independent Regulatory Board for Auditors:** a juristic person established under the s3 of the APA which is responsible for, *inter alia*, promoting the integrity of the South African Audit Profession; protecting the public in their dealings with registered auditors; prescribing standards of professional conduct and practice; promoting auditing research and education (s4 of the APA, 2005).
- **Integrity:** to be transparent and honest in all professional and business relationships (IFAC, 2006; IRBA, 2011; SAICA, 2012)
- **Legitimacy:** 'a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs and definitions' (Suchman, 1995, p. 574).
- **Management board:** in relation to the entity which has a company, the board of directors of the company and, in relation to any other entity, the body or individual(s) responsible for the management of the business of the entity (s1 of the APA, 2005; IRBA, 2006).
- **Monitoring:** a process comprising an on-going consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements, designed to provide the firm with reasonable assurance that its system of quality control is operating effectively (IAASB, 2009b; IAASB, 2009e)
- **Objectivity:** to not allow bias, conflict of interest or undue influence others to override professional or business judgements (IFAC, 2006; IRBA, 2011; SAICA, 2012)
- **Partner:** the individual responsible for the engagement and its performance and for the report that is issued on behalf of the firm (s44 of the APA, 2005; IAASB, 2009x).
- **Professional behaviour:** to comply with relevant laws and regulations and avoid actions that discredit the accounting and auditing profession (IFAC, 2006; IRBA, 2011; SAICA, 2012).
- **Professional competence and due care:** to maintain professional knowledge and skill at the level required to ensure that the client receives competent professional services

based on current developments in practice, legislation and techniques. This includes the duty to act diligently and in accordance with applicable technical and professional standards (IFAC, 2006; IRBA, 2011; SAICA, 2012).

- **Review:** appraising the quality of the work performed and conclusions reached by others.
- **Review engagement:** an assurance engagement where the objective is to enable the auditor to state, whether on the basis of procedures which do not provide all the evidence that would be required in an audit, anything has come to the auditor's attention that causes the auditor to believe that the financial statements of a client are not prepared, in all material respects, in accordance with the applicable financial reporting framework (IAASB, 2009b; IAASB, 2009y)



## IV: LIST OF REFERENCES

---

- Abbott, A. 1981. Status and status strain in the professions. *American Journal of Sociology*, 86, 819–835.
- Agulhas. 2007. IRBA Press Release: Can ethical behaviour be legislated? Available: [http://www.paab.co.za/news\\_item.asp?Item=153](http://www.paab.co.za/news_item.asp?Item=153) [Accessed August 2009].
- Ahrens, T. & Chapman, C. S. 2006. Doing qualitative field research in management accounting: Positioning data to contribute to theory. *Accounting, Organizations and Society*, 31, 819–841.
- Ahrens, T., Becker, A., Burns, J., Chapman, C. S., Granlund, M., Habersam, M., Hansen, A., Khalifa, R., Malmi, T., Mennicken, A., Mikes, A., Panozzo, F., Piber, M., Quattrone, P. & Scheytt, T. 2008. The future of interpretive accounting research: A polyphonic debate. *Critical Perspectives on Accounting*, 19, 840–866.
- Al-Thuneibat, A., Ibrahim, A., Issa, R. & Ata Baker, R. 2011. Do audit tenure and firm size contribute to audit quality? *Managerial Auditing Journal*, 26, 317–334.
- Al-Twaijry, A. A. M., Brierley, J. A. & Gwilliam, D. R. 2003. The development of internal audit in Saudi Arabia: An institutional theory perspective. *Critical Perspectives on Accounting*, 14, 507–531.
- Alvesson, M. 2003. Beyond neopositivists, romantics, and localists: A reflexive approach to interviews in organizational research. *The Academy of Management Review*, 28, 13–33.
- American Institute of Certified Public Accountants [AICPA]. 1972. Statement on Auditing Standards (SAS) No. 1. Codification of Auditing Standards and Procedures. Available: [http://www.aicpa.org/InterestAreas/AccountingAndAuditing/Community/DownloadableDocuments/ASB%20OPERATING%20POLICIES%20DOCUMENT%20\(2009-10\).pdf](http://www.aicpa.org/InterestAreas/AccountingAndAuditing/Community/DownloadableDocuments/ASB%20OPERATING%20POLICIES%20DOCUMENT%20(2009-10).pdf) [Accessed 1 September 2010].
- American Institute of Certified Public Accountants [AICPA]. 2007. Understanding the CPA's fraud-related responsibilities. Available: <http://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-00316.pdf> [Accessed 1 September 2010].
- American Institute of Certified Public Accountants [AICPA]. 2009. The AICPA Code of Professional Conduct. Available: <http://www.aicpa.org/about/code/index.htm> [Accessed 1 September 2010].
- Anderson, G. D. & Ellyson, R. C. 1986. Restructuring professional standards: The Anderson report. *Journal of Accountancy*, 162, 92–104.
- APA. 2005. Auditing Profession Act No. 26 of 2005. APA. Republic of South Africa. Pretoria: Government Printer.
- Armstrong, P. 1994. The influence of Michel Foucault on accounting research. *Critical Perspectives on Accounting*, 5, 25–55.
- Arnold, B. & De Lange, P. 2004. Enron: An examination of agency problems. *Critical Perspectives on Accounting*, 15, 751–765.

- Arping, S. & Sautner, Z. 2012. Did SOX Section 404 make firms less opaque? Evidence from cross-listed firms. *Contemporary Accounting Research*. In press.
- Asare, S., Cohen, J. & Trompeter, G. 2005. The effect of non-audit services on client risk, acceptance and staffing decisions. *Journal of Accounting and Public Policy*, 24, 489–520.
- Ashbaugh, H., LaFond, R. & Mayhew, B. W. 2003. Do nonaudit services compromise auditor independence? Further evidence. *The Accounting Review*, 78, 611–639.
- Ashbaugh, H. & Warfield, T. 2003. Audit as a corporate governance mechanism: Evidence from the German market. *Journal of International Accounting Research*, 2, 1–21.
- Ashforth, B. E. & Gibbs, B. W. 1990. The double-edge of organisational legitimation. *Organization Science*, 1, 177–194.
- Ashton, R. H. 1992. Effects of justification and a mechanical aid on judgment performance. *Organizational Behavior and Human Decision Processes*, 52, 292–306.
- Baker, R. C. & Owsen, D. M. 2002. Increasing the role of auditing in corporate governance. *Critical Perspectives on Accounting*, 13, 783–795.
- Baldvinsdottir, G., Burns, J., Nørreklit, H. & Scapens, R. 2009. The image of accountants: From bean counters to extreme accountants. *Accounting, Auditing and Accountability Journal*, 22, 858–882.
- Barth, M. E. 2008. Global financial reporting: Implications for US academics. *The Accounting Review*, 83, 1159–1179.
- Baxter, J., Boedker, C. & Chua, W. F. 2008. The future(s) of interpretive accounting research: A polyphonic response from beyond the metropolis. *Critical Perspectives on Accounting*, 19, 880–886.
- Bayou, M. E., Reinstein, A. & Williams, P. F. 2011. To tell the truth: A discussion of issues concerning truth and ethics in accounting. *Accounting, Organizations and Society*, 36, 109–124.
- Bazerman, M. H. & Moore, D. 2011. Is it time for auditor independence yet? *Accounting, Organizations and Society*, 36, 310–312.
- Bedard, J. C., Deis, D. R., Curtis, M. B. & Jenkins, G. J. 2008. Risk monitoring and control in audit firms: A research synthesis. *Auditing: A Journal of Practice Theory*, 27, 187–218.
- Bedard, J. C. 2012. Discussion of “Audit partner specialization and audit fees: Some evidence from Sweden”. *Contemporary Accounting Research*, 29, 341–348.
- Bendixen, M. 1996. A practical guide to the use of correspondence analysis in marketing research. *Marketing Research On-Line*, 1, 16–38.
- Bengtsson, E. 2011. Repoliticalization of accounting standard setting: The IASB, the EU and the global financial crisis. *Critical Perspectives on Accounting*, 22, 567–580.
- Berle, A. & Means, G. 1932. *The modern corporation and private property*. New Brunswick, New Jersey: Harcourt Brace.
- Bhagat, S. & Bolton, B. 2008. Corporate governance and firm performance. *Journal of Corporate Finance*, 14, 257–273.
- Bishop, C. C., Hermanson, D. R. & Houston, R. W. 2012. PCAOB Inspections of International Audit Firms: Initial Evidence. *International Journal of Auditing*, 1, 1–18.

- Black, J. 2008. Forms and paradoxes of principles-based regulation. *LSE Law, Society and Economy Working Papers*, 13, 1-33.
- Blankley, A. I., Kerr, D. S. & Wiggins, C. E. 2012. A content analysis of CPA firms' correspondence following PCAOB inspections: 2004-2010. *Research in Accounting Regulation*, 24, 74-89.
- Blay, A. D. & Geiger, M. A. 2013. Auditor fees and auditor independence: Evidence from going concern reporting decisions. *Contemporary Accounting Research*. 30, 579-606.
- Böhm, F., Bollen, L. H. & Hassink, H. F. 2013. Spotlight on the design of European audit committees: A comparative descriptive study. *International Journal of Auditing*. 17, 138-161.
- Boland, R. J. J. 1987. Discussion of "Accounting and the construction of the governable person". *Accounting, Organizations and Society*, 12, 267-272.
- Boolaky, P. K. 2011. Auditing and reporting in Europe: An analysis using country-level data. *Managerial Auditing Journal*, 27, 41-65.
- Boone, J. P., Khurana, I. K. & Raman, K. K. 2010. Do the Big 4 and the second-tier firms provide audits of similar quality? *Journal of Accounting and Public Policy*, 29, 330-352.
- Boswell, J. & Anderson, A. 2011. Withdrawal of information bill welcomed. *Business Day*, 19 September 2011.
- Botten, N. 2009. *Management accounting business strategy, 2009 Edition*. Oxford: CIMA Publishing.
- Bourne, P. & Minter, M. 1995. The South African audit report: An empirical investigation of the positive perceptions gap. *South African Journal of Accounting Research*, 8, 36-56.
- Bradley, M. & Chen, D. 2011. Corporate governance and the cost of debt: Evidence from director limited liability and indemnification provisions. *Journal of Corporate Finance*, 17, 83-107.
- Brennan, N. & Kelly, J. 2007. A study of whistle-blowing among trainee auditors. *The British Accounting Review*, 39, 61-87.
- Brennan, N. M. & Solomon, J. 2008. Corporate governance, accountability and mechanisms of accountability: An overview. *Accounting, Auditing & Accountability Journal*, 21, 885-906.
- Brivot, M. & Gendron, Y. 2011. Beyond panopticism: On the ramifications of surveillance in a contemporary professional setting. *Accounting, Organizations and Society*, 36, 135-155.
- Bronson, S. N., Hogan, C. E., Johnson, M. F. & Ramesh, K. 2011. The unintended consequences of PCAOB auditing Standard Nos. 2 and 3 on the reliability of preliminary earnings releases. *Journal of Accounting and Economics*, 51, 95-114.
- Bryman, B. & Bell, E. 2007. *Business research methods*. Oxford: Oxford University Press.
- Burchell, S., Clubb, C., Hopwood, A., Hughes, J. & Nahapiet, J. 1980. The roles of accounting in organizations and society. *Accounting, Organizations and Society*, 5, 5-27.
- Burchell, S., Clubb, C. & Hopwood, A. G. 1985. Accounting in its social context: Towards a history of value added in the United Kingdom. *Accounting, Organizations and Society*, 10, 381-413.

- Byington, J. R. & Sutton, S. G. 1991. The self-regulating profession: An analysis of the political monopoly tendencies of the audit profession. *Critical Perspectives on Accounting*, 2, 315–330.
- Canada, J., Kuhn, J. R. & Sutton, S. G. 2008. Accidentally in the public interest: The perfect storm that yielded the Sarbanes-Oxley Act. *Critical Perspectives on Accounting*, 19, 987–1003.
- Carcello, J. V. 2005. Discussion of "Audit Research after Sarbanes-Oxley". *Auditing: A Journal of Practice & Theory*, 24, 31–40.
- Carcello, J. V., Hollingsworth, C. & Mastrolia, S. A. 2011. The effect of PCAOB inspections on Big 4 audit quality. *Research in Accounting Regulation*, 23, 85–96.
- Carrington, T. 2010. An analysis of the demands on a sufficient audit: Professional appearance is what counts! *Critical Perspectives on Accounting*, 21, 669–682.
- Carruthers, B. G. 1995. Accounting, ambiguity, and the new institutionalism. *Accounting, Organizations and Society*, 20, 313–328.
- Causholli, M. & Knechel, W. R. 2012. Lending relationships, auditor quality and debt costs. *Managerial Auditing Journal*, 27, 550–572.
- Chahine, S. & Filatotchev, I. 2011. The effects of corporate governance and audit and non-audit fees on IPO Value. *The British Accounting Review*, 43, 155–172.
- Chambers, D. & Payne, J. 2011. Audit quality and accrual persistence: Evidence from the pre- and post-Sarbanes-Oxley periods. *Managerial Auditing Journal*, 26, 437–456.
- Chan, K., Chan, S. F. & Catherine, C. 2002. Applying QFD in the clothing manufacturing sector: A case study on improving a distance-learning program in Hong Kong. *Managerial Auditing Journal*, 17, 86–91.
- Chan, A. M. Y., Liu, G. & Sun, J. 2012. Independent audit committee members' board tenure and audit fees. *Accounting & Finance*. In press.
- Chandler, R., Edwards, R. & Anderson, M. 1993. Changing perceptions of the role of the company auditor, 1840-1940. *Accounting and Business Research*, 23, 443–459.
- Chang, H., Choy, H. L., Cooper, W. W., Parker, B. R. & Ruefli, T. W. 2009a. Measuring productivity growth, technical progress, and efficiency changes of CPA firms prior to, and following the Sarbanes-Oxley Act. *Socio-Economic Planning Sciences*, 43, 221–228.
- Chang, H., Choy, H. L., Cooper, W. W. & Ruefli, T. W. 2009b. Using Malmquist Indexes to measure changes in the productivity and efficiency of US accounting firms before and after the Sarbanes-Oxley Act. *Omega*, 37, 951–960.
- Chen, H., Chen, J. Z., Lobo, G. J. & Wang, Y. 2011. Effects of audit quality on earnings management and cost of equity capital: Evidence from China. *Contemporary Accounting Research*, 28, 892–925.
- Chiaburu, D. S. 2010. Chief executives' self-regulation and strategic orientation: A theoretical model. *European Management Journal*, 28, 467–478.
- Christopher, J. 2010. Corporate governance: A multi-theoretical approach to recognizing the wider influencing forces impacting on organizations. *Critical Perspectives on Accounting*, 21, 683–695.
- Chua, W. 1986. Radical developments in accounting thought. *Accounting Review*, 61, 601–632.

- Church, B. K. & Shefchik, L. B. 2011. PCAOB inspections and large accounting firms. *Accounting Horizons*, 26, 43–63.
- Clinch, G., Stokes, D. & Zhu, T. 2012. Audit quality and information asymmetry between traders. *Accounting & Finance*, 52, 743–765.
- Coase, R. 1937. The nature of the firm. *Economica*, 4, 386–405.
- Coetsee, D. 2011. A comment on research frameworks applied in accounting research *SA Journal of Accounting Research*, 25, 81–102.
- Cohen, J., Krishnamoorthy, G. & Wright, A. 2002. Corporate governance and the audit process. *Contemporary Accounting Research*, 19, 573–594.
- Coldwell, D. 2012. Academic. Personal Communication. Comments on: *Investigating the role of reportable irregularities in South Africa*. 7 June 2012.
- Collis, J. 2010. Audit exemption and the demand for voluntary audit: A comparative study of the UK and Denmark. *International Journal of Auditing*, 14, 211–231.
- Committee of European Securities Regulators [CESR]. 2007. Survey on the direct communication of auditors with the public on the statutory audit of the annual or consolidated accounts of listed companies. Available: [http://www.esma.europa.eu/system/files/07\\_101.pdf](http://www.esma.europa.eu/system/files/07_101.pdf) [Accessed 1 February 2013].
- Companies Act 1973. Companies Act No. 61 of 1973. *Companies Act (1973)*. Republic of South Africa. Pretoria: Government Printer.
- Companies Act 2008. Companies Act No. 71 of 2008. *Companies Act (2008)*. Republic of South Africa. Pretoria: Government Printer.
- Companies Regulations 2011. Companies Act No. 71 of 2008: *Companies Regulations (2011)*. Republic of South Africa. Pretoria: Government Printer.
- Cooper, D. J. & Robson, K. 2006. Accounting, professions and regulation: Locating the sites of professionalization. *Accounting, Organizations and Society*, 31, 415–444.
- Cooper, D. J. 2008. Is there a future for interpretive accounting research? *Critical Perspectives on Accounting*, 19, 837–839.
- Cousins, J., Mitchell, A., Sikka, P. & Willmott, H. 1998. Auditors: Holding the public to ransom. Available: <http://visar.csustan.edu/aaba/ransom.PDF>. [Accessed 6 February 2013].
- Cousins, J., Mitchell, A. & Sikka, P. 1999. Auditor liability: The other side of the debate. *Critical Perspectives on Accounting*, 10, 283–312.
- Cowton, C. J. & Dopson, S. 2002. Foucault's prison? Management control in an automotive distributor. *Management Accounting Research*, 13, 191–213.
- Creswell, J. 2003. *Research design: Qualitative, quantitative, and mixed methods approaches*. 2nd edition. London: Sage.
- Creswell, J. 2009. *Research design: Qualitative, quantitative, and mixed methods approaches*. 3rd edition. London: Sage.
- Crotty, A. 2007. Tiger-Brands price fixing scandal a drop in the ocean. *Business Report*. 7 March.
- Cullinan, C. P., Du, H. & Zheng, X. 2012. Barriers to entry to the big firm audit market: Evidence from market reaction to switches to second tier audit firms in the post-SOX period. *Research in Accounting Regulation*, 24, 6–14.

- Daniels, B. W. & Booker, Q. 2011. The effects of audit firm rotation on perceived auditor independence and audit quality. *Research in Accounting Regulation*, 23, 78–82.
- Dao, M., Raghunandan, K. & Rama, D. V. 2012. Shareholder voting on auditor selection, audit fees, and audit quality. *Accounting Review*, 87, 149–171.
- Dart, E. 2011. UK investors' perceptions of auditor independence. *The British Accounting Review*, 43, 173–185.
- Davila, T. & Wouters, M. 2005. Managing budget emphasis through the explicit design of conditional budgetary slack. *Accounting, Organizations and Society*, 30, 587–608.
- Davila, T. & Oyon, D. 2008. Cross-paradigm collaboration and the advancement of management accounting knowledge. *Critical Perspectives on Accounting*, 19, 887–893.
- DeAngelo, L. E. 1981a. Auditor independence, 'low balling', and disclosure regulation. *Journal of Accounting and Economics*, 3, 113–127.
- DeAngelo, L. E. 1981b. Auditor size and audit quality. *Journal of Accounting and Economics*, 3, 183–199.
- Dechow, P. M., Sloan, R. G. & Sweeney, A. P. 1996. Causes and consequences of earnings manipulation: An analysis of firms subject to enforcement actions by the SEC. *Contemporary Accounting Research*, 13, 1–36.
- DeFond, M. L., Raghunandan, K. & Subramanyam, K. R. 2002. Do non-audit service fees impair auditor independence? Evidence from going concern audit opinions. *Journal of Accounting Research*, 40, 1247–1274.
- DeFond, M. L. & Lennox, C. S. 2011. The effect of SOX on small auditor exits and audit quality. *Journal of Accounting and Economics*, 52, 21–40.
- Deis (Jr.), D. & Giroux, G. 1992. The determinants of audit quality in the public sector. *The Accounting Review*, 67, 462–279
- Deis, D. R. & Giroux, G. 1996. The effect of auditor changes on audit fees, audit hours, and audit quality. *Journal of Accounting and Public Policy*, 15, 55–76.
- Deker, C. 2002. King Report on corporate governance for South Africa 2002: What it means to you. Available: [http://www.mervynking.co.za/downloads/CD\\_King2.pdf](http://www.mervynking.co.za/downloads/CD_King2.pdf) [Accessed 12 November 2012].
- Deng, M., Melumad, N. & Shibano, T. 2012. Auditors' liability, investments, and capital markets: A potential unintended consequence of the Sarbanes-Oxley Act. *Journal of Accounting Research*. In press.
- Dennis, I. 2010. What do you expect? A reconfiguration of the audit expectations gap. *International Journal of Auditing*, 14, 130–146.
- Diale, A. J. 2012. The relevance or irrelevance of corporate social responsibility (CSR) to enhance government-business relations in South Africa: A theoretical exposition. *Global Conference on Business & Finance Proceedings, 2012*. Institute for Business & Finance Research, 759–764.
- Diamond, G. & Price, G. 2012. The political economy of corporate governance reform in South Africa. *South African Journal of Business Management*, 43, 57–68.
- Dickins, D. 2010. Compensation and governance. *Internal Auditing*, 35, 36–38.

- Dillard, J. 2008. A political base of a polyphonic debate. *Critical Perspectives on Accounting*, 19, 894–900.
- Dillard, J. & Roslender, R. 2011. Taking pluralism seriously: Embedded moralities in management accounting and control systems. *Critical Perspectives on Accounting*, 22, 135–147.
- DiMaggio, P. & Powell, W. 1983. The iron cage revisited: Institutional isomorphism and collective rationality in organizational fields. *American Sociology Review*, 48, 147–160.
- Dollinger, M. J. 2012. Politics, government, and business. *Business Horizons*, 55, 399–401.
- Dopuch, N., Gupta, M., Simunic, D. A. & Stein, M. T. 2003. Production efficiency and the pricing of audit services. *Contemporary Accounting Research*, 20, 47–77.
- Dozier, J. & Miceli, M. 1985. Potential predictors of whistle-blowing: A pro-social behavioural perspective. *Academy of Management Review*, 10, 823–836.
- Draft Accountancy Profession Bill 2001. Draft Accountancy Profession Bill. Republic of South Africa. Pretoria: Government Printer.
- Drury, C. 2005. *Management and cost accounting*. 6th edition. London: Thomson Learning.
- Dunn, T., Jooste, R. & Smith, P. 1989. Material irregularities and the auditor's report. *South African Journal of Accounting Research*, 3, 9–17.
- Edwards, J. R. 2001. Accounting regulation and the professionalization process: An historical essay concerning the significance of P. H. Abbott. *Critical Perspectives on Accounting*, 12, 675–696.
- Elitzur, R. & Falk, H. 1996. Planned audit quality. *Journal of Accounting and Public Policy*, 15, 247–269.
- Epps, R. W. & Guthrie, C. P. 2010. Sarbanes-Oxley 404 material weaknesses and discretionary accruals. *Accounting Forum*, 34, 67–75.
- Ernst & Young. 2010. Green Paper entitled “Audit Policy: Lessons from the crisis”. Available: [http://ec.europa.eu/internal\\_market/consultations/2010/green\\_paper\\_audit\\_en.htm](http://ec.europa.eu/internal_market/consultations/2010/green_paper_audit_en.htm) [Accessed 2 April 2011].
- European Commission. 2010a. Green Paper on Audit Policy: Frequently asked questions. Available: <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/487&format=HTML&aged=0&language=EN&guiLanguage=en> [Accessed 2 April 2011].
- European Commission. 2010b. Green Paper on Audit Policy: Lessons from the crisis. Available: <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/487&format=HTML&aged=0&language=EN&guiLanguage=en> [Accessed 2 April 2011].
- Ezzamel, M., Gwilliam, D. R. & Holland, K. M. 2002. The relationship between categories of non-audit services and audit fees: Evidence from UK companies. *International Journal of Auditing*, 6, 13–35.
- Falconer, D. & Mackay, D. 1999. The key to the mixed method dilemma. In: Proceedings of the 10th Australian Conference on Information Systems, 1999.
- Fan, J. P. H., Wei, K. C. J. & Xu, X. 2011. Corporate finance and governance in emerging markets: A selective review and an agenda for future research. *Journal of Corporate Finance*, 17, 207–214.

- Farag, M. & Elias, R. 2011. Relative audit fees and client loyalty in the audit market. *Accounting Research Journal*, 24, 79–93.
- Farrar, J. 2011. Tax fairness in Canadian government budgets: How fair is fair? *Critical Perspectives on Accounting*, 22, 365–375.
- Ferguson, A., Francis, J. R. & Stokes, D. J. 2003. The effects of firm-wide and office-level industry expertise on audit pricing. *Accounting Review*, 78, 429–448.
- Fernando, G., Abdel-Meguid, A., Elder, R. & Lubin, J. 2010. Audit quality attributes, client size and cost of equity capital. *Review of Accounting and Finance*, 9, 363–381.
- FICA 2001. Financial Intelligence Centre Act No. 38 of 2001. *FICA*. Republic of South Africa. Pretoria: Government Printer.
- Financial Reporting Council [FRC]. 2006. *Discussion Paper: Promoting Audit Quality*. Available: <http://www.frc.org.uk/images/uploaded/documents/Promoting%20Audit%20Quality%20paper%20web%20optimised1.pdf> [Accessed 2 May 2012].
- Financial Reporting Council [FRC]. 2007. Choice in the UK audit market. Interim Report of the Market Participants Group. Available: [http://www.frc.org.uk/getattachment/9fbe2f27-5331-4691-aaab-f2ac0ddf1096/Choice-Interim-MPG-Report-\(April-2007\).aspx](http://www.frc.org.uk/getattachment/9fbe2f27-5331-4691-aaab-f2ac0ddf1096/Choice-Interim-MPG-Report-(April-2007).aspx) [Accessed 2 May 2012].
- Financial Reporting Council [FRC]. 2008a. The Audit Quality Framework. Available: <http://www.frc.org.uk/images/uploaded/documents/Audit%20Quality%20Framework%20or%20web1.pdf> [Accessed 12 May 2012].
- Financial Reporting Council [FRC]. 2008b. Response to Green Paper “Audit Policy: Lessons from the Crisis”. Available: [http://ec.europa.eu/internal\\_market/consultations/2010/green\\_paper\\_audit\\_en.htm](http://ec.europa.eu/internal_market/consultations/2010/green_paper_audit_en.htm) [Accessed 12 May 2012].
- Financial Reporting Council [FRC]. 2010. Audit Inspection Unit 2009/10 Annual Report. Available: <http://www.frc.org.uk/images/uploaded/documents/AIU%20Annual%20Report%202009-10%20Final.pdf> [Accessed 1 September 2011].
- Financial Reporting Council [FRC]. 2011. FRC acts to increase transparency in corporate reporting [Online]. London: Financial Reporting Council (FRC). Available: <http://www.frc.org.uk/press/pub2632.html> [Accessed 1 September 2011].
- Firth, M., Rui, O. M. & Wu, X. 2012. How do various forms of auditor rotation affect audit quality? Evidence from China. *The International Journal of Accounting*, 47, 109–138.
- Fligstein, N. & Feeland, R. 1995. Theoretical and comparative perspectives on corporate organization. *Annual Review of Sociology*, 21, 21–43.
- Fogarty, T. J., Helan, J. B. & Knutson, D. L. 1991. The rationality of doing “nothing”: Auditors' responses to legal liability in an institutionalized environment. *Critical Perspectives on Accounting*, 2, 201–226.
- Fogarty, T. J. 1992. Organizational socialization in accounting firms: A theoretical framework and agenda for future research. *Accounting, Organizations and Society*, 17, 129–149.
- Fogarty, T. J. 1996. The imagery and reality of peer review in the US: Insights from institutional theory. *Accounting, Organizations and Society*, 21, 243–267.
- Foucault, M. 1977. *Discipline and punish: The birth of the prison*. New York: Vintage Books.



- Foucault, M. 1983. Afterword: The subject and power. In H. L. Dreyfus & P. Rabinow (Eds.), *Michel Foucault: Beyond structuralism and hermeneutics* (2nd ed., pp. 208–226). Chicago: University Press.
- Francis, J. R. & Wilson, E. R. 1988. Auditor changes: A joint test of theory relating to agency costs and auditor differentiation. *Accounting Review*, 63, 663.
- Francis, J. R. & Krishnan, J. 1999. Accounting accruals and auditor reporting conservatism. *Contemporary Accounting Research*, 16, 135–165.
- Francis, J. R. 2004. What do we know about audit quality? *The British Accounting Review*, 36, 345–368.
- Francis, J. R., Reichelt, K. & Wang, D. 2005. The pricing of national and city-specific reputations for industry expertise in the US audit market. *Accounting Review*, 80, 113–136.
- Frantz, P. 1999. Auditor's skill, auditing standards, litigation, and audit quality. *The British Accounting Review*, 31, 151–183.
- Fuerman, R. D. 2004. Accountable accountants. *Critical Perspectives on Accounting*, 15, 911–926.
- Gaa, J. C. 1991. The expectations game: Regulation of auditors by government and the profession. *Critical Perspectives on Accounting*, 2, 83–107.
- Gaber, C. & Stoica, M. 2012. Assessment of managerial performance using non-financial indicators. *Evaluarea performanței manageriale folosind indicatori nonfinanciari*, 64, 114–122.
- Gavious, I. 2007. Alternative perspectives to deal with auditors' agency problem. *Critical Perspectives on Accounting*, 18, 451–467.
- Gawith, K. 2006. Reportable irregularities. 2011. Available: [www.deneysreitz.co.za/index.php/news/reportable\\_irregularities](http://www.deneysreitz.co.za/index.php/news/reportable_irregularities) [Accessed 11 September 2011].
- Geiger, M. A. & Rama, D. V. 2006. Audit firm size and going-concern reporting accuracy. *Accounting Horizons*, 20, 1–17.
- Georgiou, O. & Jack, L. 2011. In pursuit of legitimacy: A history behind fair value accounting. *The British Accounting Review*, 43, 311–323.
- Gibbon, J. 2012. Understandings of accountability: An autoethnographic account using metaphor. *Critical Perspectives on Accounting*, 23, 201–212.
- Giddens, A. 1990. *The consequences of modernity*. Cambridge: Polity Press.
- Giddens, A. 1991. *Modernity and self-identity*. Cambridge: Polity Press.
- Gold, A., Gronewold, U. & Pott, C. 2012. The ISA 700 auditor's report and the audit expectation gap: Do explanations matter? *International Journal of Auditing*, 16, 286–307.
- Goldhamer, H. & Shils, E. A. 1939. Types of power and status. *American Journal of Sociology*, 45, 171–182.
- Gordon, C. (ed.) 1980. *Power/knowledge: Selected interviews and other writings 1972–1977*. Harlow, Essex: Pearson Education.
- Grafton, J., Lillis, A. M. & Widener, S. K. 2010. The role of performance measurement and evaluation in building organizational capabilities and performance. *Accounting, Organizations and Society*, 35, 689–706.

- Grant, P. 2011. An Aristotelian approach to sustainable business. *Corporate Governance*, 11, 4–14.
- Griffin, P. A., Lont, D. H. & Sun, Y. 2010. Agency problems and audit fees: Further tests of the free cash flow hypothesis. *Accounting & Finance*, 50, 321–350.
- Grossman, S. J. & Hart, O. D. 1983. An analysis of the principal-agent problem. *Econometrica*, 51, 7–45.
- Guénin-Paracini, H. & Gendron, Y. 2010. Auditors as modern pharmakoi: Legitimacy paradoxes and the production of economic order. *Critical Perspectives on Accounting*, 21, 134–158.
- Gumb, B. 2007. What is shown, what is hidden: Compulsory disclosure as a spectacle. *Critical Perspectives on Accounting*, 18, 807–828.
- Gwilliam, D., Macve, R. & Meeks, G. 2000. Principals and agents in crisis: Reforms of accounting and audit at Lloyd's, 1982–1986. *Accounting History*, 5, 61–92.
- Habib, A. 2011. Audit firm industry specialization and audit outcomes: Insights from academic literature. *Research in Accounting Regulation*, 23, 114–129.
- Haggerty, K. D., Wilson, D. & Smith, G. J. D. 2011. Theorizing surveillance in crime control. *Theoretical Criminology*, 12, 231–237.
- Haigh, M. & De Graaf, F. J. 2009. The implications of reform-oriented investment for regulation and governance. *Critical Perspectives on Accounting*, 20, 399–417.
- Hamann, R., Agbazue, T., Kapelus, P. & Hein, A. 2005. Universalizing corporate social responsibility? South African challenges to the international organization for standardization's new social responsibility standard. *Business and Society Review*, 110, 1–19.
- Hamilton, C., Mbenga, B. & Ross, R. 2009. *The Cambridge history of South Africa*. Cambridge, UK: Cambridge University Press.
- Hardies, K., Breesch, D. & Branson, J. 2011. Male and female auditors' overconfidence. *Managerial Auditing Journal*, 27, 105–118.
- Harmon, M. M. 2006. Business research and Chinese patriotic poetry: How competition for status distorts the priority between research and teaching in US business schools. *The Academy of Management Learning and Education*, 5, 234–243.
- Harris, L. C. & Ogbonna, E. 2011. Antecedents and consequences of management-espoused organizational cultural control. *Journal of Business Research*, 64, 437–445.
- Hassink, H., Meuwissen, R. & Bollen, L. 2010. Fraud detection, redress and reporting by auditors. *Managerial Auditing Journal*, 25, 861–881.
- Hill, C. W. L. & Jones, T. M. 1992. Stakeholder-agency theory. *Journal of Management Studies*, 29, 131–154.
- Holland, J. & Stoner, G. 1996. Dissemination of price-sensitive information and management and management of voluntary corporate disclosure. *Accounting and Business Research*, 26, 295–313.
- Holland, J. 1998a. Private disclosure and financial reporting. *Accounting and Business Research*, 28, 255–269.
- Holland, J. 1998b. Private voluntary disclosure, financial intermediation and market efficiency. *Journal of Business Finance & Accounting*, 25, 29–68.

- Holland, J. & Doran, P. 1998. Financial institutions, private acquisition of corporate information. *European Journal of Finance*, 4, 129–155.
- Holland, J. 2005. A grounded theory of corporate disclosure. *Accounting and Business Research*, 35, 249–267.
- Hopper, T. & Macintosh, N. 1993. Management accounting as disciplinary practice: The case of ITT under Harold Geneen. *Management Accounting Research*, 4, 181–216.
- Hopwood, A. G. 1987. The archaeology of accounting systems. *Accounting, Organizations and Society*, 12, 207–234.
- Hopwood, A. G. 1990. Ambiguity, knowledge and territorial claims: Some observations on the doctrine of substance over form: A review essay. *The British Accounting Review*, 22, 79–87.
- Hopwood, A. G. 2000. Understanding financial accounting practice. *Accounting, Organizations and Society*, 25, 763–766.
- Hoskin, K. W. & Macve, R. H. 1986. Accounting and the examination: A genealogy of disciplinary power. *Accounting, Organizations and Society*, 11, 105–136.
- Hoskin, K. 1994. Boxing clever: For, against and beyond Foucault in the battle for accounting theory. *Critical Perspectives on Accounting*, 5, 57–85.
- Houghton, K. A., Jubb, C. & Kend, M. 2011. Materiality in the context of audit: The real expectations gap. *Managerial Auditing Journal*, 26, 482–500.
- Humphrey, C. & Moizer, P. 1990. From techniques to ideologies: An alternative perspective on the audit function. *Critical Perspectives on Accounting*, 1, 217–238.
- Humphrey, C., Moizer, P. & Turley, S. 1992. The audit expectations gap: Plus ça change, plus c'est la même chose? *Critical Perspectives on Accounting*, 3, 137–161.
- Humphrey, C., Moizer, P. & Turley, S. 1993a. The audit expectations gap in Britain: An empirical investigation. *Accounting and Business Research*, 23, 395–411.
- Humphrey, C., Turley, S. & Moizer, P. 1993b. Protecting against detection: The case of auditors and fraud? *Accounting, Auditing & Accountability Journal*, 6, 39–62.
- Humphrey, C. 2008. Auditing research: A review across the disciplinary divide. *Accounting, Auditing & Accountability Journal*, 21, 170–203.
- Humphrey, C., Loft, A. & Woods, M. 2009. The global audit profession and the international financial architecture: Understanding regulatory relationships at a time of financial crisis. *Accounting, Organizations and Society*, 34, 810–825.
- Humphrey, C., Kausar, A., Loft, A. & Woods, M. 2011. Regulating Audit beyond the Crisis: A Critical Discussion of the EU Green Paper. *European Accounting Review*, 20, 431–457.
- Humphrey, C. 2012. Academic. Personal communication. Comments on: *Investigating the role of reportable irregularities in South Africa*. 16 April 2012.
- Huntly, I. 2011. Enterprise quality. *Business Brief*, 16, 27–29.
- Hwang, D., Staley, B., Chen, Y. & Lan, J. 2008. Confusion culture and whistle-blowing by professional accountants: An exploratory study. *Managerial Auditing Journal*, 23, 504–526.
- Ianniello, G. 2012. Non-audit services and auditor independence in the 2007 Italian regulatory environment. *International Journal of Auditing*, 16, 147–164.

- Inanga, E. L. & Schneider, W. B. 2005. The failure of accounting research to improve accounting practice: A problem of theory and lack of communication. *Critical Perspectives on Accounting*, 16, 227–248.
- Independent Regulatory Board for Auditors [IRBA]. 2006. Reportable irregularities: A guide to registered auditors. Available: [http://www.irba.co.za/index.php/component/docman/cat\\_view/19-compliance](http://www.irba.co.za/index.php/component/docman/cat_view/19-compliance) [Accessed 10 January 2012].
- Independent Regulatory Board for Auditors [IRBA]. 2009a. South African Audit Practice Statement 2 (Revised). Financial reporting frameworks and the auditor's report. In: South African Institute of Chartered Accountants (ed.) *SAICA Members' Handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- Independent Regulatory Board for Auditors [IRBA]. 2009b. South African Audit Practice Statement 3 (Revised). Illustrative independent auditor's report. In: South African Institute of Chartered Accountants (ed.) *SAICA Members' Handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- Independent Regulatory Board for Auditors [IRBA]. 2010a. Comments on EU Green Paper – Audit Policy: Lessons from the Crisis. Available: [http://ec.europa.eu/internal\\_market/consultations/2010/green\\_paper\\_audit\\_en.htm](http://ec.europa.eu/internal_market/consultations/2010/green_paper_audit_en.htm) [Accessed 5 August 2012].
- Independent Regulatory Board for Auditors [IRBA]. 2010b. South Africa ranked first out of 139 countries for its Strength of Auditing and Reporting Standards. Available: <http://www.irba.co.za/index.php/audit-news-news-42/524-3-nov-2010> [Accessed 5 August 2012].
- Independent Regulatory Board for Auditors [IRBA]. 2011. Manual of Information. Available: <http://www.irba.co.za/index.php/publications-mainmenu-121/manual-of-information-mainmenu-125> [Accessed 2 December 2011].
- Independent Regulatory Board for Auditors [IRBA]. 2012a. *About the IRBA* [Online]. Johannesburg. Available: <http://www.irba.co.za/index.php/component/content/284?task=view> [Accessed 7 November 2012].
- Independent Regulatory Board for Auditors [IRBA]. 2012b. Regulator. Personal communication: Nature and extent of irregularities reported. Monday 1 October 2012.
- Independent Regulatory Board for Auditors [IRBA]. 2012c. *South African Hat Trick As The Auditing Profession Is Ranked First Again Out of 144 Countries For The Strength of Its Auditing And Reporting Standards* [Online]. Johannesburg. Available: <http://www.irba.co.za/index.php/audit-news-news-42/648-07-september-2012> [Accessed 15 September 2012].
- Institute of Chartered Accountants in England and Wales [ICAEW]. 2004. Guidance for audit committees: Whistle-blowing arrangements. Available: <http://www.icaew.com/~media/Files/technical/Audit-and-assurance/audit/guidance-for-audit-committees/whistleblowing-arrangements> [Accessed 5 April 2012].
- Institute of Chartered Accountants in England and Wales [ICAEW]. 2010. Green Paper on Audit Policy: Lessons from the Crisis. Available: [http://ec.europa.eu/internal\\_market/consultations/2010/green\\_paper\\_audit\\_en.htm](http://ec.europa.eu/internal_market/consultations/2010/green_paper_audit_en.htm) [Accessed 1 April 2011].

- Institute of Chartered Accountants of Scotland [ICAS]. 2010. European Commission Green Paper Audit Policy: Lessons from the Crisis. Available: <[http://ec.europa.eu/internal\\_market/consultations/2010/green\\_paper\\_audit\\_en.htm](http://ec.europa.eu/internal_market/consultations/2010/green_paper_audit_en.htm)> [Accessed 1 April 2011].
- Institute of Chartered Secretaries and Administrators [ICSA]. 2010. *Good Governance: A Code for the Voluntary and Community Sector* [Online]. Available: <http://www.icsa.org.uk/assets/files/pdfs/guidance/NFP.Charities/Code%20of%20governance%20full%20version.pdf> [Accessed 19 August 2011].
- Institute of Chartered Secretaries and Administrators [ICSA]. 2011. *The NHS Constitution and Whistle-blowing* [Online]. Available: <http://www.icsa.org.uk/assets/files/pdfs/guidance/Consultations%202011/ICSA%20Response%20Whistleblowing%20and%20NHS%20Constitution.pdf> [Accessed 19 August 2011].
- Institute of Directors in Southern Africa [IOD]. 1994. *The King report on corporate governance (King-I)*. Johannesburg: Lexis Nexus.
- Institute of Directors in Southern Africa [IOD]. 2002. *The King report on corporate governance in South Africa – 2002 (King-II)*. Johannesburg: Lexis Nexus.
- Institute of Directors in Southern Africa [IOD]. 2009. *The King code of governance for South Africa (2009) and King report on governance for South Africa (2009) (King-III)*, Johannesburg: Lexis Nexus.
- Integrated Reporting Committee of South Africa [IRC]. 2011. Framework for Integrated Reporting and the Integrated Report. Available: [www.sustainabilitysa.org](http://www.sustainabilitysa.org) [Accessed 5 June 2012].
- International Accounting Standards Board [IASB], 2010. *The conceptual framework for financial reporting*. Pietermaritzburg: LexisNexis. (International Accounting Standards Committee Foundation Publications Department).
- International Auditing and Assurance Standards Board [IAASB]. 2009a. FRAME: International framework for assurance engagements, 2009 Edition, Volume 2A. In: South African Institute of Chartered Accountants (ed.) *SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB], 2009b. GLOSS1: Glossary of Terms. In: South African Institute of Chartered Accountants (ed.) *SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009c. ISA 200: Objective and General Principles Governing an Audit of Financial Statements. In: South African Institute of Chartered Accountants (ed.) *SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009d. ISA 210: Agreeing to terms of audit engagements. In: South African Institute of Chartered Accountants (ed.) *SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009e. ISA 220: Quality Control for Audits of Historical Financial Information. In: South African Institute of Chartered Accountants (ed.) *SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.

- International Auditing and Assurance Standards Board [IAASB]. 2009f. ISA 230 Audit Documentation. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009g. ISA 240: The auditor's responsibility relating to fraud in an audit of financial statements. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009h. ISA 250: Consideration of laws and regulations in an audit of financial statements. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009i. ISA 260: Communication with those charged with governance. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009j. ISA 265: Communicating deficiencies in internal control to those charged with governance and management. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009k. ISA 300: Planning an audit of financial statements. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009l. ISA 315: Identifying and assessing the risk of material misstatement through understanding the entity and its environment. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009m. ISA 330: The auditor's response to assessed risk. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009n. ISA 450: Evaluation of misstatements identified during the audit. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009o. ISA 500: Audit Evidence. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009p. ISA 530: Audit sampling. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009q. ISA 570 Going Concern. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009r. ISA 620 Using the Work of an Auditor's Expert. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.

- International Auditing and Assurance Standards Board [IAASB]. 2009s. ISA 700: Forming an opinion and reporting on financial statements *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009t. ISA 705: Modifications to the opinion in the independent auditor's report. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009u. ISAE 3000: Assurance engagements other than audits or reviews of historical financial statements. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009v. ISAE 3400: The examination of prospective financial information *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009w. ISAE 3402: Assurance reports on control at service organisations. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009x. ISQC1: Quality Control for Firms That Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009y. ISRE 2400: Engagements to review financial statements. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009z. ISRE 2410: Review of interim financial information performed by the independent auditor of the entity *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009aa. ISRS 4400: Engagements to perform agreed-upon procedures regarding financial information. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2009ab. PREF1: Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2009 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2011. ISAE 3402: Assurance reports on controls at a service organisation: Conforming amendments. *In: South African Institute of Chartered Accountants (ed.) SAICA members' handbook*. 2011 ed. Pietermaritzburg: LexisNexis.
- International Auditing and Assurance Standards Board [IAASB]. 2012. Improving the auditor's report: Invitation to comment. *Exposure Drafts and Consultation Papers* [Online]. Available: [http://www.ifac.org/sites/default/files/publications/files/Auditor\\_Reporting\\_Invitation\\_to\\_Comment-final\\_0.pdf](http://www.ifac.org/sites/default/files/publications/files/Auditor_Reporting_Invitation_to_Comment-final_0.pdf) [Accessed 8 July 2012].

- International Federation of Accountants [IFAC] 2006. Code of Professional Conduct. In: South African Institute of Chartered Accountants (ed.) *SAICA members' handbook*. 2011 ed. Pietermaritzburg: LexisNexis.
- International Integrated Reporting Committee [IIRC]. 2011. Towards integrated reporting: Communicating value in the 21st century. Available: <http://theiirc.org/wp-content/uploads/2012/06/Discussion-Paper-Summary1.pdf> [Accessed 5 June 2012].
- Jacques, E. 1961. *Equitable payment: A general theory of work, differential payment, and individual progress*. New York: Wiley.
- Jenkins, D. S., Kane, G. D. & Velury, U. 2006. Earnings quality decline and the effect of industry specialist auditors: An analysis of the late 1990s. *Journal of Accounting and Public Policy*, 25, 71–90.
- Jensen, M. C. & Meckling, W. H. 1976. Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3, 305–360.
- Jones, O., Sharifi, S. & Conway, S. 2006. Accounting for Organization: Round-up the usual suspects. *Critical Perspectives on Accounting*, 17, 283-304.
- Jubb, P. B. 1999. Whistle-blowing: A restrictive definition and interpretation. *Journal of Business Ethics*, 21, 77–94.
- Kaplan, S. E. & Ruland, R. G. 1991. Positive theory, rationality and accounting regulation. *Critical Perspectives on Accounting*, 2, 361–374.
- Kaplan, S. E. & Whitecotton, S. M. 2001. An examination of auditors' reporting intentions when another auditor is offered client employment. *Auditing: A Journal of Practice & Theory*, 20, 45–63.
- Kaplan, S. & Schultz, J. 2007. Intentions to report questionable acts: An examination of the influence of anonymous reporting channel, internal audit quality, and setting. *Journal of Business Ethics*, 71, 109–124.
- Kaplan, S. E. & Williams, D. D. 2012. The changing relationship between audit firm size and going concern reporting. *Accounting, Organizations and Society*, 37, 322–341.
- Khalifa, R., Sharma, N., Humphrey, C. & Robson, K. 2007. Discourse and audit change: Transformations in methodology in the professional audit field. *Accounting, Auditing & Accountability Journal*, 20, 825–854.
- Khan, A. R., Hossain, D. M. & Siddiqui, J. 2011. Corporate ownership concentration and audit fees: The case of an emerging economy. *Advances in Accounting*, 27, 125–131.
- King, M. E. 2012. *Integrated Reporting and the Integrated Report*. Lecture. International Corporate Governance Conference. 22 October 2012. Johannesburg, South Africa.
- Konar, L., Levitt, S., Wainer, H. E., Anderson, S. J., Barrow, R. J. G., Burdett, S., Dwinger, H. P., Garach, D., Malan, C. C., Mtoba, F., Naidoo, V., Petros, M., Pretorius, W., Ramano, T. M., Sehoole, I., Williams, G. & Wimberley, T. I. 2003. Ministerial Panel for the Review of the Draft Accountancy Profession Bill: Report to the Minister of Finance. Johannesburg, South Africa: Ministry of Finance.
- KPMG. 2010. European Commission Green Paper - Audit Policy: Lessons from the Crisis. Available: [http://ec.europa.eu/internal\\_market/consultations/2010/green\\_paper\\_audit\\_en.htm](http://ec.europa.eu/internal_market/consultations/2010/green_paper_audit_en.htm) [Accessed 26 November 2011].



- KPMG. 2011. Ethics Line. Available: <http://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Risk-Compliance/Documents/Forensic%20Ethics%20Line.pdf> [Accessed 26 November 2011].
- Krishnan, G. V. 2003. Audit quality and the pricing of discretionary accruals. *Auditing: A Journal of Practice & Theory*, 22, 109–126.
- LaPorta, R., Lopez-De-Silanes, F. & Shleifer, A. 1999. Corporate ownership around the world. *The Journal of Finance*, 54, 471–517.
- Latane, B. & Darley, J. M. 1968. Group inhibition of bystander intervention in emergencies. *Journal of Personality and Social Psychology*, 10, 215–221.
- Laughlin, R. 1995. Empirical research in accounting: Alternative approaches and a case for “middle-range” thinking. *Accounting, Auditing & Accountability Journal*, 8, 63–87.
- Laughlin, R. 2007. Critical reflections on research approaches, accounting regulation and the regulation of accounting. *The British Accounting Review*, 39, 271–289.
- Lawrence, A., Minutti-Meza, M. & Ping, Z. 2011. Can Big 4 versus non-Big 4 differences in audit-quality proxies be attributed to client characteristics? *Accounting Review*, 86, 259–286.
- Lee, T. 2006. Going where no accounting historian has gone before: A counterfactual history of the early institutionalisation of modern public accountancy. *Accounting, Auditing & Accountability Journal*, 19, 918–944.
- Lee, T. Y. & Bradlow, E. T. 2011. Automated marketing research using online customer reviews. *Journal of Marketing Research*, 48, 881–894.
- Lee, H. 2012. Incentive contracts and time pressure on audit judgment performance. *Managerial Auditing Journal*, 27, 263–283.
- Leeds, R. 1963. Altruism and norm of giving. *Merrill-Palmer Quarterly*, 9, 229–240.
- Leedy, P. D. & Ormrod, J. E. 2001. *Practical research: Planning and design*. New Jersey: Prentice Hall.
- Lesage, C. & Wechtler, H. 2012. An inductive typology of auditing research. *Contemporary Accounting Research*, 29, 487–504.
- Li, D. 2010. Does auditor tenure affect accounting conservatism? Further evidence. *Journal of Accounting and Public Policy*, 29, 226–241.
- Liao, Y., Chi, W. & Chen, Y. 2013. Auditor economic dependence and accounting conservatism: Evidence from a low litigation risk setting. *International Journal of Auditing*, 17, 117–137.
- Lim, C.-Y. & Tan, H.-T. 2008. Non-audit service fees and audit quality: The impact of auditor specialization. *Journal of Accounting Research*, 46, 199–246.
- Lin, Z. J. & Liu, M. 2009. The impact of corporate governance on auditor choice: Evidence from China. *Journal of International Accounting, Auditing and Taxation*, 18, 44–59.
- Lin, J. W. & Hwang, M. I. 2010. Audit quality, corporate governance, and earnings management: A meta-analysis. *International Journal of Auditing*, 14, 57–77.
- Lin, Z. J. & Liu, M. 2010. The determinants of auditor switching from the perspective of corporate governance in China. *Advances in Accounting*, 26, 117–127.
- Llewellyn, S. 1996. Theories for theorists or theories for practice? Liberating academic accounting research? *Accounting, Auditing & Accountability Journal*, 9, 112–117.

- Llewelyn, S. 2003. What counts as "theory" in qualitative management and accounting research? *Accounting, Auditing & Accountability Journal*, 16, 662–708.
- Low, M., Davey, H. & Hooper, K. 2008. Accounting scandals, ethical dilemmas and educational challenges. *Critical Perspectives on Accounting*, 19, 222–254.
- MacLulich, K. K. 2003. The emperor's 'new' clothes? New audit regimes insights from Foucault's *Technologies of the self*. *Critical Perspectives on Accounting*, 14, 791–811.
- Malsch, B. & Gendron, Y. 2009. Mythical representations of trust in auditors and the preservation of social order in the financial community. *Critical Perspectives on Accounting*, 20, 735–750.
- Malsch, B. & Gendron, Y. 2011. Reining in auditors: On the dynamics of power surrounding an "innovation" in the regulatory space. *Accounting, Organizations and Society*, 36, 456–476.
- Manuel, T. 2002. Budget speech by the minister of finance. Available: <http://www.info.gov.za/speeches/2002/020220246p1001.htm> [Accessed 20 March 2012].
- Marnet, O. 2007. History repeats itself: The failure of rational choice models in corporate governance. *Critical Perspectives on Accounting*, 18, 191–210.
- Maroun, W., Turner, M. & Sartorius, K. 2011. Does capital gains tax add to or detract from the fairness of the South African tax system? *South African Journal of Economic and Management Sciences*, 14, 436–448.
- Maroun, W. 2012a. Interpretive and critical research: Methodological blasphemy! *African Journal of Business Management*, 6, 1–6.
- Maroun, W. 2012b. Notions of audit quality: The case for reportable irregularities in South Africa. In: Proceedings of the British Accounting and Finance Association: Annual Conference and Doctoral Colloquium, 2012, Brighton, United Kingdom.
- Maroun, W. 2012c. SOX: A comparison with the South African status quo. *Journal of Modern Accounting and Auditing*, 8, 357–365.
- Maroun, W., Coldwell, D. & Joosub, T. 2012. The paradox of trust and regulation effectiveness: A conceptual model. In: Proceedings of the International Corporate Governance Conference, 2012, Johannesburg, South Africa. School of Accountancy, University of the Witwatersrand.
- Maroun, W. & Gowar, C. 2013. South African auditors blowing the whistle without protection: A challenge for trust and legitimacy. *International Journal of Auditing*, 17, 177–189.
- Maroun, W. & Wainer, H. 2013. To report or not to report: In what context is a 'reportable irregularity' reportable? *South African Journal of Economic and Management Sciences*, 16, 13–25.
- Martens, S. C. & McEnroe, J. E. 1992. Substance over form in auditing and the auditor's position of public trust. *Critical Perspectives on Accounting*, 3, 389–401.
- Mayhew, B. W. & Pike, J. E. 2004. Does investor selection of auditors enhance auditor independence? *Accounting Review*, 79, 797–822.
- Mboyisa, C. 2009. Presidential hot-line rings off the hook. *The Citizen*. 14 September.
- McCann, L., Solomon, A. & Solomon, J. F. 2003. Explaining the growth in UK socially responsible investment. *Journal of General Management*, 28, 15–36.

- McKinlay, A. & Pezet, E. 2010. Accounting for Foucault. *Critical Perspectives on Accounting*, 21, 486–495.
- McMillan, K. P. 2004. Trust and the virtues: A solution to the accounting scandals? *Critical Perspectives on Accounting*, 15, 943–953.
- Merchant, K. A. 2008. Why interdisciplinary accounting research tends not to impact most North American academic accountants. *Critical Perspectives on Accounting*, 19, 901–908.
- Merkel-Davies, D., Brennan, N. & Vourvachis, P. 2011. Text analysis methodologies in corporate narrative reporting research. *23rd CSEAR International Colloquium*. St Andrews, United Kingdom.
- Messner, M. 2009. The limits of accountability. *Accounting, Organizations and Society*, 34, 918–938.
- Meyer, J. W. & Rowan, B. 1977. Institutionalized organizations: Formal structure as myth and ceremony. *American Journal of Sociology*, 83, 340–363.
- Miceli, M. P. & Near, J. P. 1984. The relationships among beliefs, organizational position, and whistle-blowing status: A discriminant analysis. *The Academy of Management Journal*, 27, 687–705.
- Miller, P. & O'Leary, T. 1987. Accounting and the construction of the governable person. *Accounting, Organizations and Society*, 12, 235–265.
- Mimmack, G., Meyer, D. & Manas, G. 2001. *Introductory statistics for business: The analysis of business data*. Cape Town: Pearson Education.
- Mitchell, A. & Sikka, P. 2002. Dirty business: The unchecked power of major accountancy firms. Available: <http://visar.csustan.edu/aaba/DirtyBusiness.pdf>. [Accessed 8 January 2013].
- Mitra, S. & Hossain, M. 2011. Corporate governance attributes and remediation of internal control material weaknesses reported under SOX Section 404. *Review of Accounting and Finance*, 10, 5–29.
- Mitschow, M. C. & Langford, D. 2000. Whistle-blowing by independent auditors: An extension of general ethical resistance models. *Research on Accounting Ethics*, 6, 91–106.
- Molm, L. D. 1986. Gender, power, and legitimation: A test of three theories. *American Journal of Sociology*, 91, 1356–1386.
- Molm, L. D. 1989. Punishment power: A balancing process in power-dependence relations. *American Journal of Sociology*, 94, 1392–1418.
- Moore, D. C. 1991. Accounting on trial: The critical legal studies movement and its lessons for radical accounting. *Accounting, Organizations and Society*, 16, 763–791.
- Mosso, D. 2003. A long fall from grace. *Research in Accounting Regulation*, 16, 259–264.
- Myers, J. N., Myers, L. A. & Omer, T. C. 2003. Exploring the term of the auditor-client relationship and the quality of earnings: A case for mandatory auditor rotation? *The Accounting Review*, 78, 779–799.
- Nagy, A. 2012. Audit partner specialization: The case of Andersen followers. *Managerial Auditing Journal*, 27, 251–262.
- Nam, D. & Lemak, D. 2007. The whistle-blowing zone: Applying Bernard's insights to a modern ethical dilemma. *The Journal of Management History*, 13, 33–42.

- Near, J. P. & Miceli, M. P. 1995. Effective whistle-blowing. *The Academy of Management Review*, 20, 679–708.
- Negash, M., Abdol-Samad, T., Rabin, E., Lerman, J., Oosthuizen, A., Oosthuizen, T., Singh, D., Swartz, N., Padia, N., Patron, S., Gibbon, C. & Hassan, Y. 2003. Final Research Report to the Ministerial Panel for the Review of the Draft Accountancy Profession Bill and National Treasury Johannesburg, South Africa: University of the Witwatersrand, School of Accountancy.
- Negash, M. 2004. *Audit hazard and legal regimes: Analysis of the reform issues in South Africa*. Johannesburg: University of the Witwatersrand. Unpublished.
- Neimark, M. 1990. The king is dead. Long live the king! *Critical Perspectives on Accounting*, 1, 103–114.
- Nel, H. C. 2001. Commission of enquiry into the affairs of the Masterbond Group and investor protection in South Africa. Cape Town, South Africa: South African Government.
- Neuendorf, K. 2002. *The content analysis guidebook*. Thousand Oaks, CA: Sage Publications.
- Nondorf, M. E., Singer, Z. & You, H. 2012. A study of firms surrounding the threshold of Sarbanes-Oxley section 404 compliance. *Advances in Accounting*, 28, 96–110.
- Novakowski, N. & Wellar, B. 2008. Using the Delphi technique in a normative planning research: Methodological design considerations. *Environment and Planning*, 40, 1485–1500.
- Oakes, L., Townley, B. & Cooper, D. 1998. Business planning as pedagogy: Language and control in a changing institutional field. *Administrative Science Quarterly*, 43, 257–293.
- Odendaal, E. & De Jager, H. 2008. Regulation of the auditing profession in South Africa. *The Southern African Journal of Accountability and Auditing Research*, 8, 1–13.
- O'Dwyer, B., Owen, D. & Unerman, J. 2011. Seeking legitimacy for new assurance forms: The case of assurance on sustainability reporting. *Accounting, Organizations and Society*, 36, 31–52.
- Oosthuizen, C. 2011. Leadership – a road less travelled. *Business Brief*, 16, 26.
- Opperman, F. 2009. Reportable irregularities: Creating a culture of compliance. *Accountancy SA*, October, 28–30.
- Ouchi, W. 1979. A conceptual framework for the design of organizational control mechanisms. *Management Science*, 25, 833–848.
- Owhoso, V. & Weickgenannt, A. 2009. Auditors' self-perceived abilities in conducting domain audits. *Critical Perspectives on Accounting*, 20, 3–21.
- PAAA 1951. Public Accountants' and Auditors' Act No. 80 of 1951. PAAA. Republic of South Africa. Pretoria: Government Printers.
- Paisey, C. & Paisey, N. J. 2012. Whose rights? Professional discipline and the incorporation of a (human) rights framework: The case of ICAS. *Critical Perspectives on Accounting*, 23, 17–35.
- Palmrose, Z.-V. 1988. An analysis of auditor litigation and audit service quality. *The Accounting Review*, 63, 55.
- Palmrose, Z.-V. 1997. Audit litigation research: Do the merits matter? An assessment and directions for future research. *Journal of Accounting and Public Policy*, 16, 355–378.

- Parker, L. & Roffey, B. 1997. Methodological themes. Back to the drawing board: Revisiting grounded theory and the everyday accountant's and manager's reality. *Accounting, Auditing and Accountability Journal*, 10, 212–247.
- Parker, L. D. 2007. Financial and external reporting research: The broadening corporate governance challenge. *Accounting & Business Research*, 37, 39–54.
- Payne, N. 2012. *The role of governance in shaping the future of South Africa*. Lecture. International Corporate Governance Conference. 23 October 2012. Johannesburg, South Africa.
- Peecher, M. E., Schwartz, R. & Solomon, I. 2007. It's all about audit quality: Perspectives on strategic-systems auditing. *Accounting, Organizations and Society*, 32, 463–485.
- Peel, M. J. & Makepeace, G. H. 2012. Differential audit quality, propensity score matching and Rosenbaum Bounds for confounding variables. *Journal of Business Finance & Accounting*, 39, 606–648.
- Pentland, B. T. 1993. Getting comfortable with the numbers: Auditing and the micro-production of macro-order. *Accounting, Organizations and Society*, 18, 605–620.
- Pentland, B. T. 2000. Will auditors take over the world? Program, technique and the verification of everything. *Accounting, Organizations and Society*, 25, 307–312.
- Pesqueux, Y. 2005. Corporate governance and accounting systems: A critical perspective. *Critical Perspectives on Accounting*, 16, 797–823.
- POCA 1998. *Prevention of Corrupt Activities Act No. 121 of 1998*. POCA. Republic of South Africa. Pretoria: Government Printers.
- Porter, B. 1993. An empirical study of the audit expectation-performance gap. *Accounting and Business Research*, 24, 49–68.
- Porter, B., Ó hÓgartaigh, C. & Baskerville, R. 2012. Audit expectation-performance gap revisited: Evidence from New Zealand and the United Kingdom. Part 1: The gap in New Zealand and the United Kingdom in 2008. *International Journal of Auditing*, 16, 101–129.
- Powell, W. 2007. The new institutionalism. 2007. Available: <http://www.stanford.edu/group/song/papers/NewInstitutionalism.pdf> [Accessed 17 October 2011].
- Powell, W. 2010. Does auditor tenure affect accounting conservatism? Further evidence. *Journal of Accounting and Public Policy*, 29, 226–241.
- Power, M. 1991. Auditing and environmental expertise: Between protest and professionalisation. *Accounting, Auditing & Accountability Journal*, 4, 30–42.
- Power, M. 1992. From common sense to expertise: Reflections on the prehistory of audit sampling. *Accounting, Organizations and Society*, 17, 37–62.
- Power, M. 1994. *The audit explosion*. London: Demos. Power, M. 1995. Auditing, expertise and the sociology of technique. *Critical Perspectives on Accounting*, 6, 317–339.
- Power, M. 1997. Expertise and the construction of relevance: Accountants and environmental audit. *Accounting, Organizations and Society*, 22, 123–146.
- Power, M. 1999. *The audit society: Rituals of verification*. Oxford: Oxford University Press.
- Power, M. 2003. Auditing and the production of legitimacy. *Accounting, Organizations and Society*, 28, 379–394.

- PricewaterhouseCoopers [PwC]. 2006. Reportable irregularities. Available: <http://www.pwc.co.za/en/publications/index.jhtml> [Accessed 10 November 2009].
- PricewaterhouseCoopers [PwC]. 2009. Steering Point: King III. Available: <http://www.pwc.com/za/en/publications/steering-point.jhtml> [Accessed 30 November 2011].
- PricewaterhouseCoopers [PwC]. 2010. PwC Response to Green Paper on Audit Quality. Available: [http://ec.europa.eu/internal\\_market/consultations/2010/green\\_paper\\_audit\\_en.htm](http://ec.europa.eu/internal_market/consultations/2010/green_paper_audit_en.htm) [Accessed 30 November 2011].
- PricewaterhouseCoopers [PwC]. 2011a. Cybercrime: Protecting against the growing threat. Global Economic Crime Survey. Available: [http://www.pwc.com/en\\_GX/gx/economic-crime-survey/assets/GECS\\_GLOBAL\\_REPORT.pdf](http://www.pwc.com/en_GX/gx/economic-crime-survey/assets/GECS_GLOBAL_REPORT.pdf) [Accessed 30 November 2011].
- PricewaterhouseCoopers [PwC]. 2011b. Whistleblowing: The importance of speaking up. Available: [http://www.pwc.com/en\\_GX/gx/ifrs-reporting/pdf/world-watch-issue-2-2011-interactive.pdf](http://www.pwc.com/en_GX/gx/ifrs-reporting/pdf/world-watch-issue-2-2011-interactive.pdf) [Accessed 30 November 2011].
- Public Accountants' and Auditors' Board [PAAB]. 2003. Material irregularities: A guide for registered auditors and accountants. *Out of circulation*.
- Public Company Accounting Oversight Board [PCAOB]. 2006. *Observations on the initial implementation of the process for addressing quality control criticisms within 12 months after an inspection report, PCAOB Release No. 104-2006-078* [Online]. Washington, DC: PCAOB. Available: [http://pcaobus.org/Inspections/Documents/2006\\_03-21\\_Release\\_104-2006-078.pdf](http://pcaobus.org/Inspections/Documents/2006_03-21_Release_104-2006-078.pdf) [Accessed 1 September 2012].
- Public Company Accounting Oversight Board [PCAOB]. 2007. *Report on the second-year implementation of Auditing Standard No. 2: An audit of internal control over financial reporting performed in conjunction with an audit of financial statements* [Online]. Washington, DC: PCAOB. Available: [http://pcaobus.org/Inspections/Documents/2006\\_03-21\\_Release\\_104-2006-078.pdf](http://pcaobus.org/Inspections/Documents/2006_03-21_Release_104-2006-078.pdf) [Accessed 1 September 2012].
- Puttick, G. & van Esch, S. 2003. *The principles and practices of auditing*. Cape Town: Juta.
- Quattrone, P. 2004. Accounting for God: Accounting and accountability practices in the Society of Jesus (Italy, XVI-XVII centuries). *Accounting, Organizations and Society*, 29, 647–683.
- Quattrone, P. & Hopper, T. 2005. A 'time-space odyssey': Management control systems in two multinational organisations. *Accounting, Organizations and Society*, 30, 735–764.
- Read, W. & Rama, D. 2003. Whistle-blowing to internal auditors. *Managerial Auditing Journal*, 18, 354–362.
- Reckers-Sauciuc, A. K. & Lowe, D. J. 2010. The influence of dispositional affect on whistle-blowing. *Advances in Accounting*, 26, 259–269.
- Reiter, S. A. & Williams, P. F. 2002. The structure and progressivity of accounting research: The crisis in the academy revisited. *Accounting, Organizations and Society*, 27, 575–607.
- Riotto, J. J. 2008. Understanding the Sarbanes-Oxley Act: A valued added approach for public interest. *Critical Perspectives on Accounting*, 19, 952–962.

- Roberts, J. & Scapens, R. 1985. Accounting systems and systems of accountability: Understanding accounting practices in their organisational contexts. *Accounting, Organizations and Society*, 10, 443–456.
- Roberts, J. 1991. The possibilities of accountability. *Accounting, Organizations and Society*, 16, 355–368.
- Roberts, J. 2001. Trust and control in Anglo-American systems of corporate governance: The individualizing and socializing effects of processes of accountability. *Human Relations*, 54, 1547–1572.
- Roberts, J., Sanderson, P., Barker, R. & Hendry, J. 2006. In the mirror of the market: The disciplinary effects of company/fund manager meetings. *Accounting, Organizations and Society*, 31, 277–294.
- Roberts, J. 2009. No one is perfect: The limits of transparency and an ethic for 'intelligent' accountability. *Accounting, Organizations and Society*, 34, 957–970.
- Rockness, H. & Rockness, J. 2005. Legislated ethics: From Enron to Sarbanes-Oxley, the impact on corporate America. *Journal of Business Ethics*, 57, 31–54.
- Rodrigues, L. L. & Craig, R. 2007. Assessing international accounting harmonization using Hegelian dialectic, isomorphism and Foucault. *Critical Perspectives on Accounting*, 18, 739–757.
- Rosman, A. 2011. Auditors' going-concern judgments: Rigid, adaptive, or both? *Review of Accounting and Finance*, 10, 30–45.
- Rossouw, G. J., Van der Watt, A. & Malan, D. P. 2002. Corporate governance in South Africa. *Journal of Business Ethics*, 37, 289–302.
- Rotter, J. 1966. Generalized expectancies for internal vs. external control of reinforcement. *Psychological monographs*, 80, 1–28.
- Rowley, J. 2012. Conducting research interviews. *Management Research Review*, 35, 260–271.
- Sainty, B., Taylor, G. & Williams, D. 2002. Investor dissatisfaction toward auditors. *Journal of Accounting, Auditing and Finance*, 17, 111–136.
- Scapens, R. W. 2008. Seeking the relevance of interpretive research: A contribution to the polyphonic debate. *Critical Perspectives on Accounting*, 19, 915–919.
- Schmidt, J. J. 2012. Perceived auditor independence and audit litigation: The role of non-audit services fees. *Accounting Review*, 87, 1033–1065.
- Schultz, J. J., Jr., Johnson, D. A., Morris, D. & Dyrnes, S. 1993. An investigation of the reporting of questionable acts in an international setting. *Journal of Accounting Research*, 31, 75–103.
- Seifert, D. L., Sweeney, J. T., Joireman, J. & Thornton, J. M. 2010. The influence of organizational justice on accountant whistle-blowing. *Accounting, Organizations and Society*, 35, 707–717.
- Shaked, A. & Sutton, J. 1981. The self-regulating profession. *Review of Economic Studies*, 48, 217–234.
- Shleifer, A. & Vishny, R. W. 1997. A survey of corporate governance. *The Journal of Finance*, 52, 737–783.

- Shotland, R. L. & Huston, T. L. 1979. Emergencies: What are they and do they influence bystanders to intervene? *Journal of Personality and Social Psychology*, 37, 1822–1834.
- Sikka, P. 1992. Audit policy making in the UK. *European Accounting Review*, 1, 349–392.
- Sikka, P. & Willmott, H. 1995. The power of "independence": Defending and extending the jurisdiction of accounting in the United Kingdom. *Accounting, Organizations and Society*, 20, 547–581.
- Sikka, P., Puxty, A., Willmott, H. & Cooper, C. 1998. The impossibility of eliminating the expectations gap: Some theory and evidence. *Critical Perspectives on Accounting*, 9, 299–330
- Sikka, P. 2004. Some questions about the governance of auditing firms. *Int J Discl Gov*, 1, 186–200.
- Sikka, P. 2009. Financial crisis and the silence of the auditors. *Accounting, Organizations and Society*, 34, 868–873.
- Sikka, P., Filling, S. & Liew, P. 2009. The audit crunch: Reforming auditing. *Managerial Auditing Journal*, 24, 135–155.
- Simunic, D. A. 1980. The pricing of audit services: Theory and evidence. *Journal of Accounting Research*, 18, 161–190.
- Smart, B. 2002. *Michael Foucault*. Cornwall, First published by Ellis Horwood Limited. Republished by Routledge.
- Smith-Lacroix, J.-H., Durocher, S. & Gendron, Y. 2012. The erosion of jurisdiction: Auditing in a market value accounting regime. *Critical Perspectives on Accounting*, 23, 36–53.
- Solano, F. & Kleiner, B. 2003. Understanding and preventing workplace retaliation. *Management Research News*, 26, 206–211.
- Solomon, I. & Trotman, K. T. 2003. Experimental judgment and decision research in auditing: The first 25 years of AOS. *Accounting, Organizations and Society*, 28, 395–412.
- Solomon, J. 2009. Directions for Corporate Governance. In: ACCA (ed.). London: Certified Accountants Educational Trust.
- Solomon, J. 2010. *Corporate Governance and Accountability, 3rd Edition*. West Sussex: Wiley.
- Solomon, J. & Maroun, W. 2012. Integrated reporting: The new face of social, ethical and environmental reporting in South Africa? In: ACCA (ed.). London: The Association of Chartered Certified Accountants.
- South African Institute of Chartered Accountants [SAICA]. 2004. *Circular 05/01: Material irregularities in terms of s20(5) of the Public Accountants' and Auditors' Act, 1991*. Pietermaritzburg: Interpak Books.
- South African Institute of Chartered Accountants [SAICA]. 2007. Letter for auditors to send to clients outlining the requirements of Section 45 of the Auditing Profession Act – The duty to report on reportable irregularities *SAICA Handbook*. Pietermaritzburg: Interpak Books.
- South African Institute of Chartered Accountants [SAICA]. 2012. Code of Professional Conduct for Chartered Accountants. Available: <https://www.saica.co.za/Portals/0/Technical/accounting/documents/Code%20of%20Professional%20Conduct.pdf> [Accessed 10 November 2012].



- SOX 2002. Sarbanes-Oxley Act of 2002, Pub. L. 107-204, 116 Stat. 745. SOX. United States of America.
- Staub, E. 1978. *Positive Social Behavior and Morality: Social and Personal Influences*. New York: Academic Press.
- Steenkamp, L., Baard, R. & Frick, B. 2009. Factors influencing success in first-year accounting at a South African university: A comparison between lecturers' assumptions and students' perceptions. *South African Journal of Accounting Research*, 23, 113–140.
- Stein, M. J. 2008. Beyond the boardroom: Governmental perspectives on corporate governance. *Accounting, Auditing & Accountability Journal*, 21, 1001–1025.
- Suchman, M. C. 1995. Managing legitimacy: Strategic and institutional approaches. *The Academy of Management Review*, 20, 571–610.
- Sweeney, J. T. & Roberts, R. W. 1997. Cognitive moral development and auditor independence. *Accounting, Organizations and Society*, 22, 337–352.
- Sy, A. & Tinker, T. 2008. Sarbanes-Oxley: An endangered specie? *Critical Perspectives on Accounting*, 19, 927–930.
- Talaulicar, T. 2010. The concept of the balanced company and its implications for corporate governance. *Society and Business Review*, 5, 232–244.
- Tian, G. Y. & Twite, G. 2011. Corporate governance, external market discipline and firm productivity. *Journal of Corporate Finance*, 17, 403–417.
- Tillema, S. & ter Bogt, H. J. 2010. Performance auditing: Improving the quality of political and democratic processes? *Critical Perspectives on Accounting*, 21, 754–769.
- Tremblay, M.-S. & Gendron, Y. 2011. Governance prescriptions under trial: On the interplay between the logics of resistance and compliance in audit committees. *Critical Perspectives on Accounting*, 22, 259–272.
- Turner, M. & Maroun, W. 2010. Capital gains tax in South Africa. *Southern African Accounting Association, Johannesburg Region*. Johannesburg, South Africa.
- Uddin, S. & Choudhury, J. 2008. Rationality, traditionalism and the state of corporate governance mechanisms: Illustrations from a less-developed country. *Accounting, Auditing & Accountability Journal*, 21, 1026–1051.
- Unerman, J. & O'Dwyer, B. 2004. Enron, WorldCom, Andersen et al.: A challenge to modernity. *Critical Perspectives on Accounting*, 15, 971–993.
- Vakkur, N. V., McAfee, R. P. & Kipperman, F. 2010. The unintended effects of the Sarbanes-Oxley Act of 2002. *Research in Accounting Regulation*, 22, 18–28.
- van Aswegen, F. 2000. Controlling crime: A comparison of the policies of South African political parties. *Society in Transition*, 31, 126–144.
- van Esch, S., Negash, M., Firer, S., Oosthuizen, T., Abdol-Samad, T., Padia, N. & Patron, S. 2004. International audit quality control standards: A South African perspective. Report to the Public Accountants' & Auditors' Board Johannesburg. South Africa: University of the Witwatersrand, School of Accountancy
- Vaughn, M. & Ryan, L. V. 2006. Corporate governance in South Africa: A bellwether for the continent? *Corporate Governance: An International Review*, 14, 504–512.

- Vecchiato, P. 2011. *Busa appeals for public interest defence in bill* [Online]. Johannesburg. Available: <http://www.businesslive.co.za/southafrica/2011/11/22/bus-a-appeals-for-public-interest-defence-in-bill> [Accessed 23 November 2011].
- Velury, U. 2003. The association between auditor industry specialization and earnings management. *Research in Accounting Regulation*, 16, 171–184.
- Ventovuori, T., Lehtonen, T., Salonen, A. & Nenonen, S. 2007. A review and classification of academic research in facilities management. *Facilities*, 25, 227–237.
- Victoravich, L. M. 2010. The mediated effect of SAS No. 99 and Sarbanes-Oxley officer certification on jurors' evaluation of auditor liability. *Journal of Accounting and Public Policy*, 29, 559–577.
- Vinten, G. 2000. Perspectives: Whistle-blowing towards quality. *Total Quality Management*, 12, 166–171.
- Vinten, G. 2003. Whistle-blowing: The UK experience. *Management Decision*, 41, 935–943.
- Walsh, E. J. & Stewart, R. E. 1993. Accounting and the construction of institutions: The case of a factory. *Accounting, Organizations and Society*, 18, 783–800.
- Watts, R. & Zimmerman, J. L. 1976. *Positive Accounting Theory*. Upper Saddle River, NJ: Prentice-Hall.
- Watts, R. & Zimmerman, J. L. 1978. Towards a positive theory of the determination of accounting standards. *The Accounting Review*, 53, 112–134.
- Watts, R. & Zimmerman, J. 1979. The demand for and supply of accounting theories: The market for excuses. *The Accounting Review*, 54, 273–305.
- Watts, R. & Zimmerman, J. L. 1983. Agency problems, auditing, and the theory of the firm: Some evidence. *Journal of Law and Economics*, 26, 613–633.
- Weetman, P. 2012. Academic. Personal communication. Comments on: *Investigating the role of reportable irregularities in South Africa*. 16 April 2012
- West, A. 2006. Theorising South Africa's corporate governance. *Journal of Business Ethics*, 68, 433–448.
- Wielligh, P. V. 2006. Irregularities: Material or reportable? *Accountancy SA*, April, 10–13.
- Wielligh, P. V. 2007. Reportable irregularities. *Accountancy SA*, February, 18–21.
- Willmott, H. 2008. Listening, interpreting, commending: A commentary on the future of interpretive accounting research. *Critical Perspectives on Accounting*, 19, 920–925.
- Windsor, C. & Warming-Rasmussen, B. 2009. The rise of regulatory capitalism and the decline of auditor independence: A critical and experimental examination of auditors' conflicts of interests. *Critical Perspectives on Accounting*, 20, 267–288.
- Wines, G. 2012. Auditor independence: Shared meaning between the demand and supply sides of the audit services market? *Managerial Auditing Journal*, 27, 5–40.
- WPA 1989. *Whistleblower Protection Act of 1989*, Pub. L. 101-12, 103 Stat. 16. WPA. United States of America.
- Wyatt, A. R. 2004. Accounting professionalism: They just don't get it! *Accounting Horizons*, 18, 45-53.

- Zeff, S. A. 2003a. How the US accounting profession got where it is today: Part I. *Accounting Horizons*, 17, 189-205.
- Zeff, S. A. 2003b. How the US accounting profession got where it is today: Part II. *Accounting Horizons*, 17, 267-286.
- Zerni, M. 2012. Audit partner specialization and audit fees: Some evidence from Sweden. *Contemporary Accounting Research*, 29, 312–340.
- Zucker, L. 1986. Production of trust: Institutional sources of economic structure, 1840–1920. *Research in Organizational Behaviour*, 8, 53–11.